No. 328.

Supreme Court of the United States.

OCTOBER TERM, 1938.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

R. J. REYNOLDS TOBACCO COMPANY.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

BRIEF FOR THE RESPONDENT.

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OPINIONS BELOW.

The opinion of the Board of Tax Appeals (R. 20–28) is reported in 35 B. T. A. 949. The opinion of the Circuit Court of Appeals (R. 70–78), reversing the Board, is reported in 97 F. (2d) 302.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered June 6, 1938 (R. 78). The petition for certiorari was filed September 6, 1938 (R. 78), and granted October 17, 1938 (R. 78). The jurisdiction of this Court rests on section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

The question here presented is not the abstract question of whether this case is governed by the provisions of one regulation or another.

The question is whether a tenable statutory construction applied for approximately 25 years with the repeated affirmation of Regulations, Decisions and Rulings of the Department, by Board and Court decisions, and by repeated reenactments of the statute, has the force and effect of law; and whether the Court below correctly decided that, under those circumstances, and under the rule of this Court, such statutory construction should not be overthrown.

The Commissioner is asking that a construction placed upon a statutory definition (general in its terms)[1] by the Treasury Department and applied over a period of approximately 25 years, shall be held invalid, void, untenable, and unsupportable on any reasonable basis.

The Court below found and held that the said long continued construction has a reasonable basis to support it, and that it has the support of numerous Board decisions, court decisions, and text authorities. The Court below also found and held that a different construction would likewise be tenable. Under these circumstances the Court below applied the rule laid down by this Court to govern such cases, and sustained the long continued construction placed upon the statute by the Treasury Department. The Court below further held that since the departmental construction had for many years received the affirmation of the Board of Tax Appeals and of the Courts, and had received the sanction of Congress in five successive carefully considered revenue acts, such construction is controlling under the circumstances of this case.

The question therefore is whether the Court below was correct in following the rule of this Court applicable in such circumstances.

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[1] Reference to Sec. 22 (a) of the Act, *infra* p. 67, shows that Congress in express words called it a "*General definition.*"

HOW THE ISSUE AROSE.

This was a petition to the Circuit Court of Appeals for the Fourth Circuit to review an order of the Board of Tax Appeals finding a deficiency in income tax for the year 1929, in the amount of $37,865.62. The issue arose in this way:

The Commissioner determined a deficiency on a transaction totally unrelated to the transaction here in question, and mailed deficiency notice on April 3, 1933. He did not determine that the instant transaction was taxable and made no determination of deficiency relative thereto. Taxpayer filed petition in the Board of Tax Appeals on May 4, 1933. Answer was filed on June 27, 1933. Thereafter the cause was at issue for approximately three years, during which time the parties worked out an agreement and settlement of the only issue in the case. Then, on February 15, 1936, the Commissioner filed an amended answer in which he pleaded in effect that the Regulations in force in 1929, and under which taxpayer had made the instant transaction, were invalid and that the taxpayer had realized taxable income from said instant transactions in 1929. Taxpayer filed reply to said amended answer on March 14, 1936, and pleaded that the transactions in question had been made under and pursuant to the provisions of the Revenue Act of 1928, and the Regulations duly promulgated thereunder, and that the construction placed upon the statute by Departmental Regulations, Decisions and Rulings, and by Board and Court decisions, had continued for many years, and that during that period the revenue act had been repeatedly reenacted without change. Taxpayer pleaded the rule of this Court applicable under such circumstances as a complete bar to recovery of an additional deficiency arising by reason of the instant transactions. The petitioner further pleaded that the said construction was a sound construction and that the transactions in question were not taxable.

The Board found for the Commissioner. The taxpayer sought review in the Circuit Court of Appeals for the Fourth Circuit. That Court reversed the Board and held that the case is governed by the doctrine and rule of this Court that if a

statute is reasonably susceptible of two constructions, its reenactment, after a construction by responsible officials has been long maintained, amounts to a legislative sanction of that construction.

STATEMENT.

The facts, as found by the Board of Tax Appeals, appear at R. 14–20. The facts as found by the Court below appear at R. 70–74. The facts are not in dispute.[1] They may be summarized as follows:

Taxpayer corporation had issued its stock for cash. Thereafter it reacquired certain shares of its own stock for cash. Such acquisition was not pursuant to any contract agreement. Such stock was later reissued for cash, to persons desiring to acquire stock of the company. The original certificates were cancelled and new certificates issued.

The acquisition and reissue of such stock was effected for the purpose of protecting and preserving (1) the reputation of the company, (2) the reputation of the company's products and brands, and (3) the reputation of the company's stock. Each such transaction was made by the company under conditions which necessitated such action and under the necessity of protecting the company's business from a threatened peril (R. 16, bot. 17, near bot. 52, mid. 53, bot. 53, mid. 54, bot. 54, top 55, bot. 55, mid. 56). The company acquired none of this stock as a medium of payment in any transaction in which the company sold an asset or a commodity (R. bot. 60). The company's charter did not authorize it to deal in stocks of any kind. The company did not believe that these transactions constituted dealing in stock (R. bot. 57, top 58). The company has never dealt in corporate shares (R. mid. 60). The sole purpose in the instant transactions was to protect the company and its business in a special situation (R. top 57, bot. 57, mid.

[1] Taxpayer would, however, call attention to a minor error occurring in the 3d paragraph of R. 18, where the date mentioned should read "September 18, 1929," instead of "December 18, 1929." See record near bot. p. 54.

59, mid. 56). The reissuance of the stock here involved occurred in 1929. Some of the stock so reissued in 1929 had been acquired by the company in 1921 and had been held by the company as treasury stock since that time. The remaining shares so reissued had been acquired earlier in the year 1929 (R. 14, bot. 18, top 19, near bot. 72).

All said reacquisitions and reissues of its stock were made solely for cash and in no instance for anything except cash (R. near bot. 19, 14, 44, 45, 58) and at the open market price (R. 14, 51, 59) as quoted on the exchange (R. mid. 51). None of such transactions were margin transactions (Stip. #9, R. 44). The company was not speculating or trafficking in its stock for a profit, as it was within its power to acquire the stock at much lower prices (R. near bot. 56). The company wanted to get its stock generally into the hands of its employees and was willing to let them have it at cost (R. top 57). The company never conceived that its transaction was a dealing or trafficking in stock (R. top 58).

The company made said transactions in view of departmental regulations, rulings and decisions, then in force and effect, and in the belief that the departmental regulations were correct and controlling (R. top 20, near top 52, mid. 73). Its tax return conformed to the Regulations (R. top 21).

Under the Revenue Act of 1918, the Department promulgated Regulations 45, Art. 542, holding that where a corporation acquires stock previously issued by it, the sale of such stock constitutes a capital transaction and the proceeds of such sale constitutes capital and not income of the corporation, and that a corporation realizes no gain or loss from the purchase or sale of its own stock. That construction was applied by Departmental Rulings to prior Revenue Acts (the Revenue Acts of 1913 and 1916) and to the Corporation Tax Act of 1909.

That Regulation was continued without change down to 1934. During that period the Department issued many rulings and decisions supporting and reaffirming that regulation. The Commissioner repeatedly defended that regulation before the Board of Tax Appeals. The Board repeatedly

affirmed it by published decisions. The Regulation received the approval of the Circuit Courts of Appeals.

In 1929 these regulations, rulings and decisions were in force and effect and were at that time being continuously applied and vigorously defended by the Department,[1] and in 1929 the taxpayer made its transactions. A more detailed chronology of the history of the long continued construction will be set forth hereinafter.

In 1934, the Department issued *Treasury Decision 4430*, C. B. XIII-1, 36. That was after the established rule had been applied for about 25 years, by rulings and decisions of the Department and about 16 years after it had remained continuously in the Regulations, and about 5 years after the taxpayer had made its instant transactions. The effect of *Treasury Decision 4430* was to declare invalid and of no effect all the Regulations, Rulings and Decisions above referred to. The Commissioner invoked this new ruling in the instant case some 3 years after the instant cause was at issue in the Board.

In the instant case the position of the Commissioner is that: (1) the long continued regulations, rulings and decisions of the Bureau, the Board, and the Courts, are null and void and of no effect, (2) that they are and have always been plainly and obviously wrong and untenable and without any reason to support them, (3) that the repeated reenactments of the statute, without change, give no support to them, and (4) that they were invalid and void in 1929 and in all the years during which they were in effect and while they were being enforced by the Department.

STATUTES AND REGULATIONS INVOLVED.

These are printed in Appendix A, *infra*, pp. 67-69.

[1] In his brief filed in the Board in 1926, in *Emerson Electric Co.*, 3 B. T. A. 932, the Commissioner cited and quoted Art. 542 of Reg. 45 and argued (as he had done in all the previous cases) that the Regulation was not contrary to the intent and purpose of the Revenue Act's definition of income, but that it was fully in accord therewith; and then said: "*This regulation has been applied and followed for so long as to become stare decisis under the principle announced by the Supreme Court in the Flannery case.*"

SYNOPSIS OF RESPONDENT'S CONTENTIONS.

First: The Court below properly found that the Regulations and Decisions of long standing were reasonable.

Second: The Court below properly decided that since there was reason to support the interpretation contained in the long continued Regulation and Decisions, and since the statute has been repeatedly reenacted without change in light of such long continued construction, the Regulation has received the approval of the Congress, has the force and effect of law, and its overthrow is not now plainly required and it may not now be overthrown as clearly and plainly wrong.

Third: The application of a new and different regulation retroactively (over that portion of the years to 1924) is not a sporadic discrimination but is deliberate and capricious and leads to unjust, oppressive and inconsistent results, and violates the rule of uniformity in taxation.

Fourth: The cases relied upon below by the Commissioner for his *volte face* in interpreting the statute do not support him since they relate to transactions totally different from the instant transaction.

ARGUMENT.

It is submitted that the Court below correctly applied the rule, under the well established doctrine of this Court, that when a statute is reasonably susceptible of two constructions, its repeated reenactment in light of an interpretative ruling by responsible officials, amounts to a legislative sanction of the course pursued, and especially when the construction has been long maintained and several reenactments of the statutory language have taken place (R. Mid. 77). The decision of the Court below was just and proper.

The Decision of the Court Below Does Not Sustain a Contention which Exempts Income from Taxation.

The decision below does not purport to uphold an exemption from taxation, as has been suggested by the Commissioner.

The decision is specifically grounded on the proposition that there is reason and authority to support the long continued construction put upon the statute, and that accordingly the duty of the Court was clear in applying literally the mandate of this Court applicable under the circumstances.

The long continued rule of construction was that in transactions of this kind no income could or did accrue to the corporation,[1] and that the sale by a corporation of its own reacquired stock constitutes a capital transaction and the proceeds of such sale do not constitute income because a corporation realizes no gain or loss on the purchase or sale of its own stock.[2] It is thus apparent that the long continued construction is not one which *exempts* a taxpayer's gain from taxation. *Eisner* v. *Macomber*, 252 U. S. 189, 207.

The Decision of the Court Below is Correct.

It should first be clearly understood exactly what the Court below decided. It decided only that, as between two reasonable constructions of the statute, that construction which has received long and continuous application by responsible officials, and in light of which several reenactments of the statute have taken place, must be held to have received legislative sanction.

Three main elements appear in the decision: (1) the duration of the construction, (2) the presence of reason to support it, and (3) the repeated reenactments of the statute, without change, during the continuance of that construction.

The history and long duration of the construction will be set forth in chronological form showing its long continued application. That there is authority and reason to support it is shown by the numerous decisions rendered in support of it, over a long period of years, by many responsible departmental officials, by the Board of Tax Appeals, and by the Courts. The

[1] *Law Opinion 296*, 5 C. B. top 210, issued under the 1913 Act; A. R. R. 693, 5 C. B. 207, bot. 209.

[2] Reg. 45, Art. 542; Reg. 62, Art. 543; Reg. 65, Art. 543; Reg. 69, Art. 543; Reg. 74, Art. 66; Reg. 77, Art. 66.

reenactments of the revenue act speak for themselves. The history of the construction, the support it has had in many considered opinions and decisions, and the reenactments of the statute will be here briefly, but by no means exhaustively, reviewed.

Very early in the history of income taxation the construction of the statutory *general definition* of income, as applied to transactions of the kind here involved, came under consideration by the departmental officials charged with the duty of administering the statute and promulgating regulations pursuant thereto. The then outstanding authorities on the subject were in general agreement that reacquired, or treasury, stock was not property, or a commodity, in the hands of the issuing corporation; that the issue of such stock has the same effect as the original issue of such stock; and that the issuance of such stock was a capital issue and constituted a capital transaction resulting in neither gain nor loss. Among such authorities were the many text writers on the subject whose views were to the same effect and have, without substantial variance, prevailed from that day down to the present.

Among such authorities are the following:

Esquerre, "*Applied Theory of Accounts.*" (See 2 C. B. 211.)

Dickinson, "*Accounting Practice & Procedure,*" 130, 132.

Paton, "*Accountants' Hand Book,*" 931-2, 980-1.

Paton, "*Accounting Theory,*" (1922), pp. 380-385.

Paton, "*Accounting Terminology,*" p. 119.

Wildman and Powell, "*Capital Stock Without Par Value,*" 93-4.

Sunley and Pinkerton, "*Corporation Accounting,*" 121.

Kester, "*Accounting Theory and Practice,*" 17.

Glenn, "*Treasury Stock,*" 15 Va. L. R. 625, 637.

Esquerre, "*Practical Accounting Problems,*" Part II, 1922, 6-81.

Hills, "*Stated Capital and Treasury Shares,*" Journal of Accountancy, Vol. 57, Jan. to June, 1934, 202, 212, 213.

Marple, "*Treasury Stock,*" Journal of Accountancy, Vol. 57, Jan. to June, 1934, 257, 262–3.

Holmes, "*Federal Taxes,*" (6th Ed.) p. 236.

Morowetz on Private Corporations (2d Ed.), Vol. 1, sec. 112, p. 109.

Montgomery, "*Income Tax Procedure,*" Vol. 1, 1926 Ed. p. 690; Vol. 1, 1927 Ed. p. 331; 1938 Ed., p. 27.[1]

Streightoff, "*Advanced Accounting,*" 134–5.

Hatfield, "*Accounting,*" 183.

Sanders, Hatfield and Moore, "*Statement of Accounting Principles,*" 90.

Payne, "*Treasury or Reacquired Stock,*" The Certified Public Accountant (Feb. 1936), Vol. 16, 98.

Holt and Morris, "*Some Aspects of Reacquired Stock,*" Harvard Business Review, XII, 507–8.

Federal Trade Commission, "Release #131," March 13, 1934.

Federal Reserve Board Bulletin, "Verification of Financial Statements" (1929 Revision).

May, "*Recent Opinions on Dealings in Treasury Stock,*" Journal of Accountancy, Vol. 66, 17 (July, 1938).

Report of Committee on Accounting Procedure, American Institute Accountants (May, 1938), Journal of Accountancy, Vol. 65, 417–418, which is reprinted in full in Appendix C, *infra, p.* 74.

The rule is variously stated by the authorities: *Dickinson, supra,* says:[2]

> An important question arises as to the treatment of stock of a corporation held in its own treasury. * * *
> * * * The capital stock represents the manner in which its property and assets are distributed among those who constitute the corporation. If one of these owners disposes of his share to the corporation, he withdraws therefrom,

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[1] In his 1938 Edition, Montgomery reviews the decision of the Court below in the instant case and says: "The decision is sound."

[2] As quoted in A. R. R. 799, C. B. I–1, 374 (1922).

taking with him what he considers his fair proportion of the asset value, and leaving the rest to be divided among the remaining owners. * * * [For example]: A corporation has a capital stock of $1,000,000, divided into 10,000 shares of $100 each, and represented by assets of equal value. The holders of 1,000 shares withdraw, i. e., sell their shares to the company at the book value which in this case is par. The stock is thereby reduced to 9,000 shares, i. e., $900,000, and the assets are similarly reduced by the payment of $100,000 to $900,000. There is clearly no reason whatsoever for pretending that there are still 10,000 shareholders and assets of $1,000,000 when as a matter of fact there are only 9,000 with assets of $900,000, and the position of those 9,000 is entirely unchanged.

Paton's *Accountants' Handbook*,[1] *supra:*

It has already been stated that the term "treasury stock" applies properly only to reacquired stock—that is, issued stock no longer outstanding in the hands of the public because of purchase by or donation to the corporation. (p. 934.)

When treasury stock is resold, any gain resulting from the excess of the selling price over par or average stated value should be regarded as a contribution of a stockholder and credited to paid-in surplus. * * * (p. 935.)

Surplus arising from a company's dealings in its own stock is clearly analogous to paid-in surplus, * * *. The transaction clearly results in a realignment of legal rights, * * *. (p. 980.)

Paton's *Accounting Terminology, supra,* says that surplus consists of capital surplus and earned surplus; that capital surplus includes paid-in surplus, and that paid-in surplus includes the gains on resales of treasury stock.

Wildman & Powell, supra, pp. 93–94:

Next may be considered the question of acquiring treasury stock at one price and disposing of it at a higher

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[1] W. A. Paton, Phd. D., C.P.A., Professor of Accounting at University of Michigan.

price. Two transactions of this character undoubtedly give rise to what generally is termed a profit. * * * However, treasury stock probably may not be regarded as in the same category with merchandise. * * * Consequently it seems not unreasonable to argue that the two transactions just mentioned are merely two adjustments of the capital account.

Hatfield's Accounting, supra, 183:

For income tax purposes, however, the proceeds of the sale of treasury stock do not constitute income of the corporation.

Sunley and Pinkerton, supra, 121:

When a *commodity* is sold by a corporation it passes out of its possession, and ordinarily the deal is closed; *but when shares* are sold the deal really continues on, for the buyers of these shares are taken into participation in the corporation's financial affairs. * * *

No corporation is organized for the declared purpose of making profits on transactions in its own stock. *Such profits are hardly "earnings" and should be classified as paid-in surplus.* (Italics supplied.)

Kester, supra, says that when treasury stock is resold, any gain on the sale should be carried to surplus account as a contribution to capital.

Hills, supra, discusses the subject at length and says that it is obviously unwise to subject earnings to increase or decrease coincident with the acquisition and sale of treasury shares. He concludes: *"The transactions of a corporation in its own shares should be considered as capital transactions."*

Marple, supra, says:

When treasury stock is sold, the sales price would be recorded as a debit to cash (or other asset) and a credit to "Surplus applied in acquisition of treasury stock" * * *.

If * * * the stock were sold for more than cost * * * the * * * excess over cost would represent additional contributed capital and be credited to capital surplus.

Glenn, supra, concisely summarizes the rule thus:

> In truth, then, treasury stock is not stock at all * * *. Forever do we have to return to this hard realism—when a corporation gives anything for its own stock the corporation is out an asset. Against that it has left only the possibility that some day, under some circumstances, it may succeed in again getting value back into the treasury to replace the value it has lost, by the process of again selling this treasury stock, which meanwhile, in actual truth, represents a void.

In practical business affairs the rule is likewise applied. The following quotation is from a New York Stock Exchange Bulletin issued to all listed companies under date of December 18, 1933:

> The repurchase by a corporation of its outstanding stock amounts, in effect, to a reduction in capital.
>
> A corporation which carries its own reacquired stock as an asset may sell these holdings at any time without notice. *Such sales, in effect, represent an increase in capital* without the detailed information which would be required if the corporation were issuing additional stock. (Italics supplied.)

The *Federal Trade Commission* in its "*Registration Statement*" required by the Securities Division of that Commission, for filing under the Federal Securities Act of 1933, directs that applicants for registration of security issues must deduct treasury stock from total capital stock, to include the excess of the proceeds from the sale of capital stock over the par or stated value thereof as paid-in surplus, and to include discount on capital stock as capital surplus.

Likewise, the *Federal Trade Commission* in its *Release #131* of March 13, 1934, in administering the Securities Act of 1933, held that treasury stock originally issued before the effective date of that Act must be registered under that Act before it may be sold. By this ruling that Commission holds that treasury stock is in no wise different from unissued stock, when

it is disposed of by the issuing corporation. The Commission's ruling is obviously predicated upon the sound principle that when a corporation acquires its own stock for cash it is merely paying off one stockholder and when it *disposes of the same stock it is securing another stockholder who is adding capital to the corporation.* The fact that one stockholder may be willing to relinquish his holdings for a price less than some other stockholder may be willing to pay for that interest in the corporation, does not in any way add to the income of the corporation, but merely adds to its capital.

The *Federal Reserve Board*, Washington, D. C., in the 1929 revision of its Bulletin entitled "Verification of Financial Statements" submits a recommended form of balance sheet in which treasury stock is deducted from issued stock in the corporation's capital stock accounts.

The rule is epitomized in the oft quoted statement of Judge L. Hand in *Borg* v. *International Silver Co.*, 11 F. (2d) 147, 150 (1925), relative to treasury shares:

> * * * It is clear, from the way in which it treated the shares in 1908 and afterwards, that the defendant did not suppose the shares were retired, or were to be. If so, it would not have carried them as treasury stock for 15 years. * * *
>
> * * * Such shares are of necessity retired in this sense: That they constitute no longer any liability of the defendant. A corporation can have no right of action against itself, as must be if the share is truly a liability. * * *
>
> To carry the shares as a liability, and as an asset at cost, is certainly a fiction, however admirable. They are not a liability, and on dissolution could not be so treated, because the obligor and obligee are one. They are not a present asset, because, as they stand, the defendant can not collect upon them. What in fact they are is an opportunity to acquire new assets for the corporate treasury by creating new obligations. In order to indicate this potentiality, it may be the best accounting to carry them as an asset at cost, providing, of course, all other assets are so carried. Even so, a company which revalued its assets might properly carry them at their sale value when the revaluation was made. In any event there can

> be no ambiguity in stating the facts more directly, as the defendant did; that is, in treating the shares as not in existence while held in the treasury, except as a possible source of assets at some future time, when by sale at once they become liabilities and their proceeds assets. It makes no difference whether this satisfies ideal accounting or not.

The Treasury Department gave careful consideration to this question in light of existing authorities, and ruled that if a corporation reacquires shares of its own stock previously issued by it, and later sells and reissues such stock, such sale constitutes a capital transaction and the proceeds of the sale constitute capital and not income to the corporation. This construction was later adopted as a departmental *Regulation* with the approval of the Secretary (Regulations 45, Art. 542, promulgated under the Revenue Act of 1918). Soon thereafter, the Department promulgated *Law Opinion 1035*, 2 C. B. 132, approving the rule and stating that it applied with equal force to the Revenue Act of 1916 and to the Corporation Tax Act of 1909. Soon after that the Department promulgated ruling *A. R. R. 693*, 5 C. B. 207, 209, stating that the provisions of the Regulation applied to revenue acts prior to the Revenue Act of 1918.

From that time forward, and down to 1934, the above principles were affirmed and reaffirmed year after year, by repeated Departmental Rulings and by continuous inclusions in the Departmental Regulations promulgated under each succeeding Revenue Act—each Revenue Act being reenacted in light of such continued construction, and in each instance without change. The chronology of these Departmental Rulings and Regulations is as follows:

Law Opinion 296, 5 C. B. top p. 210.[1]
Law Opinion 426, 5 C. B. mid. p. 210.[2]

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[1] The date of L. O. 296 is not given but it is stated that it was issued under the Revenue Act of 1913.

[2] The date of L. O. 426 is not given but it is stated that it was issued under the Revenue Act of 1916.

1919 *Revenue Act of 1918.*

1920 *Treasury Regulations 45, Art. 542 and 563*, pursuant to 1918 Act.

1920 *Law Opinion 1035*, 2 C. B. 132.

1920 *Law Opinion 1035* (Revised), 3 C. B. 160, 162.

1921 *Treasury Decision 3206*, 23 T. D. 763.

1921 *A. R. R. 693*, 5 C. B. 207.

1921 *Revenue Act of 1921.*

1922 *Treasury Decision 3295*, 24 T. D. 207, promulgating *Treasury Regulations 62, Art. 543 and 563*, pursuant to 1921 Act.

1922 *I. T. 1198*, C. B. I–1, 275.

1922 *A. R. R. 799*, C. B. I–1, 374.

1923 *I. T. 1736*, C. B. II–2, 274.

1923 *I. T. 1802*, C. B. II–2, 267.

1924 *Revenue Act of 1924.*

1924 *Treasury Decision 3640*. 26 T. D. 745, promulgating *Treasury Regulations 65, Art. 543 and 563*, pursuant to 1924 Act.

1924 *S. M. 2205*, C. B. III–2, 244.

1924 *A. R. R. 8159*, C. B. III–2, 256.

1926 *Revenue Act of 1926.*

1926 *Treasury Regulations 69, Art. 543 and 563*, pursuant to 1926 Act.

1928 *Revenue Act of 1928.*

1928 *Treasury Regulations 74, Arts. 66 and 176*, pursuant to 1928 Act.

1932 *Revenue Act of 1932.*

1932 *Treasury Regulations 77, Art. 66 and 176*, pursuant to 1932 Act.

1934 *Revenue Act of 1934.*[1]

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[1] When the Revenue Bill of 1934 was under consideration by Congress the Sub-Committee of the Ways & Means Committee officially reported on Dec. 4, 1933, as follows:

> The Sub-committee have given attention to these matters nearly continuously except for the months of August and September. In connection with their investigations *they have had full cooperation from representatives of the Treasury Department, of the legislative counsel's office of the House, and of the staff of the Joint Committee on Internal Revenue Taxation.*

Let us examine briefly some of those decisions of the Treasury Department. They are all to the same effect.

The Regulations (Nos. 45, 1918 Act; 62, 1921 Act; 65, 1924 Act; 69, 1926 Act; 74, 1928 Act; 77, 1932 Act) speak for themselves. They all are alike and all state the rule as set out in Art. 66, Reg. 74, in Appendix A.

The decisions of the Treasury Department set forth the reason and philosophy supporting those Regulations. They were issued by the officials charged with the obligation of interpreting and administering the Acts.

Law Opinion 296, supra, issued by the Solicitor of Internal Revenue under the 1913 Act, said:

> The stock of a corporation held by any person *other than the corporation which issued it* of course constitutes an asset and one receiving in exchange capital stock of ascertained market value greater than the cost to him of the asset given in exchange might realize a taxable profit from the transaction, but when stock is acquired by the corporation which issued it, in exchange for assets of the corporation, the transaction has an entirely different character. *The stock is then necessarily diminished in value by the amount of the assets which the corporation has exchanged for it* * * *. The whole exchange from the standpoint of the O Company was a capital transaction: capital stock, a bookkeeping capital liability, was acquired and extinguished *by a surrender of assets including capital assets, the beneficial interest in which was previously represented by the stock acquired. No income could or did accrue to the O Company from this transaction. Its capital account alone was affected.* * * * (Italics supplied.)

Under the *Revenue Act of 1916,* the principle was supported in *Law Opinion 426 supra.*

Law Opinion 1035, 2 C. B. 132, was promulgated in the spring of 1920 under the 1918 Act. It held that where a corporation purchased shares of its own stock and later resold it at a profit, no part of the proceeds of such sale should be included in gross income.

Law Opinion, 1035 (Revised), *supra,* in the autumn of 1920, reaffirmed the principle.

Thus it is seen that the application of this principle goes back to the very beginning of the income tax.

A. R. R. 693,[1] *supra*, was rendered in the autumn of 1921. It cited and quoted with approval the previous *Law Opinions, supra*, and *Esquerre, supra*. It approved the definition of "treasury stock" set out in existing Regulations:

> *Treasury stock wherever and whenever the term is used in connection with the accounts of the corporation or for income tax purposes*, will be held to mean stock which had been previously issued by the corporation and *which had been repossessed by it through purchase* or otherwise, *and then carried on its books as an asset*. (Italics supplied.)

The decision reviewed the entire subject matter and concluded:

> In view of the foregoing matters, the Committee concludes that the transaction in the instant case was a capital one and not one in which there resulted a loss from the sale, exchange or other disposition of property such as may properly be deducted in the computation of taxable net income * * *.

A. R. R. 799, supra, appeared in 1922. Therein the *taxpayer contended that treasury stock (reacquired stock) was an asset in its hands*. The decision discussed the subject exhaustively, quoted extensively from *Dickinson, supra*, cited many Court cases, and dismissed the taxpayer's contention and held that treasury stock could not constitute an asset in the hands of the issuing corporation. The decision said:

> *It will be seen that the above definition can not include a corporation's own stock which it has purchased from its stockholders in the open market for the simple reason that whatever the corporation pays to the stockholder for his share of stock is a withdrawal by such stockholder of the amount of capital originally contributed to the capital stock of the*

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[1] "A. R. R." is the citation of a decision of the "*Committee on Appeals and Review*" which was a Departmental Appellate Body. It was in effect the forerunner of the *Board of Tax Appeals* which in effect supplanted it in 1924.

> *company. By such withdrawal the share which his interest represented is extinguished because it has been so withdrawn. The amount of capital originally contributed still in the hands of the corporation constitutes the remaining capital stock, of which it can not be said that the interest formerly represented by the share of the withdrawing stockholder is a part.* (Italics supplied.)

The many other Departmental Decisions listed *supra*, are to the same effect.

It was in light of the Departmental Decisions that the Regulations were issued and reissued; and it was in light of those Decisions and Regulations that the Statute was repeatedly reenacted without change. As will be shown later, after 1924 the statutes were so reenacted in light of additional decisions to the same effect rendered by the Board of Tax Appeals and by the Courts.

From the foregoing it is seen that the rule was applied by the Treasury Department through Rulings, Decisions and Regulations from 1909 down to and including the time of the passage of the Revenue Act of 1934—a period of approximately 25 years. During that long period of years the rule was made the subject of consideration, ruling, decision and affirmation by not less than seven Solicitors and General Counsels, six Commissioners of Internal Revenue, and five Secretaries of the Treasury.

In the meantime, however, the Board of Tax Appeals had come into existence in 1924. The Commissioner repeatedly argued before the Board in support of the Departmental construction,[1] and the Board repeatedly affirmed it. The Board held in *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803 (1925) that where a corporation sold shares of its own stock which it had previously reacquired, no loss occurred to the corporation. That decision was followed by the Board and applied under varying states of fact:

1925 *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803.
1925 *Cooperative Furniture Co.*, 2 B. T. A. 165.

1925 *Atlantic Carton Co.*, 2 B. T. A. 380.
1926 *Emerson Electric Co.*, 3 B. T. A. 932.[1]
1926 *Illinois Rural Credit Ass'n*, 3 B. T. A. 1178.
1926 *Hutchins Lumber & Storage Co.*, 4 B. T. A. 705.
1926 *Farmers Deposit National Bank*, 5 B. T. A. 520.
1926 *H. S. Crocker Co.*, 5 B. T. A. 537, 541.
1926. *Interurban Construction Co.*, 5 B. T. A. 529.
1926 *Liberty Agency Co.*, 5 B. T. A. 778.
1927 *Simmons Company*, 8 B. T. A. 631, 645; aff'd 33 F. (2d) 75 (CCA 1); cert. denied 280 U. S. 588.
1928 *Union Trust Co.*, 12 B. T. A. 688, 690.
1929 *105 West 55th Street, Inc.*, 15 B. T. A. 210, 213; aff'd 42 F. (2d) 849 (CCA 2).
1929 *Riggs National Bank*, 17 B. T. A. 615, 618; aff'd 57 F. (2d) 980 (CCA 4).
1930 *J. H. Johnson*, 19 B. T. A. 840, 847; aff'd 56 F. (2d) 58 (CCA 5); cert. denied 286 U. S. 551.
1930 *American Cigar Co.*, 21 B. T. A. 464, 495; aff'd 66 F. (2d) 425 (CCA 2); cert. denied 290 U. S. 699.
1930 *Inland Finance Co.*, 23 B. T. A. 199; aff'd 63 F. (2d) 886 (CCA 9).
1932 *Carter Hotel Co.*, 25 B. T. A. 933; aff'd 67 F. (2d) 642 (CCA 4).

In each of the above cases it was the Treasury Department which contended for the rule for which the instant taxpayer now contends. During that period of several years the Commissioner in those cases held that no gain or loss occurred when a corporation reacquired its own stock for cash and later reissued it for cash. The Board and the Courts consistently sustained the Commissioner.

The rule insisted upon by the Commissioner, and sustained by those decided cases, is shown by reference to a few of such cases.

In *Simmons & Hammond Mfg. Co.* (1925), *supra*, the

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[1] See footnote, bot. p. 6, *supra*.

corporation reacquired shares of its own stock for cash and later reissued them for cash. The taxpayer contended this treasury stock constituted an asset in its hands and its sale gave rise to gain or loss. *The Commissioner contended that it was not an asset and that no gain or loss resulted. The Board said:*

> It was urged upon us that shares of its issued and outstanding stock repurchased by a corporation, representing treasury stock, are in as full a sense an asset as would be Liberty Bonds or commercial securities. An analysis of this position discloses its fallacy. Such bonds and securities have an asset value totally divorced from any liability thereon of the corporation holding them. The capital liability of such a corporation remains undisturbed by the purchase of such securities. It is readily apparent that such is not the case where a corporation purchases shares of its own stock. Irrespective of how the corporation may choose to treat such stock, there is nevertheless a very real shifting and adjustment of assets and liabilities which takes place perforce. There may be such a treatment of the transaction by the corporation as to show a bookkeeping loss or gain (as was the case here), but it is not actual and real. For that reason we hold that there was in the instant appeal no actual or realized loss. We are of opinion that the method used in this transaction by the corporation was in truth and fact a distribution of surplus to Simmons and Hammond. Much could be said in support of this view upon an analysis of the manner in which the sale was made to Simmons and Hammond, but we are satisfied that our conclusion is correct on principle and does not require the support of such analysis. The determination of the Commissioner in this respect is approved.

In *Hutchins Lumber & Storage Co.* (1926), *supra*, the Board said:

> The important facts upon which we must adjudge the character of this transaction are—that the Booth-Kelley Lumber Co. had acquired this stock from the petitioner for the sum of $30,000, which became a part of the petitioner's paid-in surplus; that upon the repurchase of this stock the petitioner returned to the Booth-Kelley

Lumber Co. the latter's contribution of $30,000 capital and its share in the petitioner's accumulated surplus. *It was a capital transaction involving a return to this particular stockholder of its capital contribution plus its share in the accumulated surplus, and the paid-in capital and surplus, of which these funds were a part, were lessened by the withdrawal of the same. The purchase by a corporation of its own capital stock eliminates the stockholder without substituting another in his place, repays to the withdrawing member his share of the capital, and reduces the amount of the fund contributed to the common venture.* See *Appeal of Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803. (Italics supplied.)

In *Farmers Deposit National Bank*, 5 B. T. A. 520 (1926), the Board said:

That a corporate taxpayer realizes no taxable gain from the sale of its own capital stock *is a well established principle of the taxing statutes. It is a principle which the Commissioner has consistently adhered to in all of the regulations promulgated under the several Revenue Acts.* In the *Appeal of Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803, this Board held that the sale by a corporate taxpayer of its own capital stock constituted a capital transaction and that no deductible loss resulted therefrom. It follows, *per contra*, that a corporate taxpayer realizes no taxable gain from the sale of its own capital stock. (Italics supplied.)

In *H. S. Crocker Co.* (1926), *supra*, the Board said: "We have heretofore held that dealings by a corporation in its own capital stock give rise to no profit or loss. *Appeal of Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803."

In *Liberty Agency Co.* (1926), *supra*, the Board said:

We are of opinion that the petitioner realized no taxable gain when it purchased its own preferred stock at a cost to it of $5,025 less than its stockholders had theretofore paid for it. *This was wholly a capital transaction. Appeal of Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803. * * * (Italics supplied.)

In *Simmons Company* (1927), *supra*, affirmed 33 F. (2d) 75 (1929), certiorari denied 280 U. S. 588, 74 L. ed. 637, the Board said:

> We think this is properly conceded in view of the previous decisions of this Board that *a corporation can have no gain or loss on the sale or purchase of its own stock.* See *Appeal of Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803. * * * (Italics supplied.)

In *Union Trust Co.* (1928), *supra*, the Board said:

> We see no basis on which the petitioner can escape the conclusion that this stock was owned by it and that the sale was no more nor less than a sale by it of its own capital stock. The Board has previously held that no taxable gain or loss results when a corporation buys or sells its own capital stock. *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803; *Farmers Deposit Nat'l Bank*, 5 B. T. A. 520; *Simmons Co.*, 8 B. T. A. 631.

105 West 55th St., Inc. (1929), *supra*, affirmed 42 F. (2d) 849 (1930), the Board sustained the Commissioner, saying (p. 213):

> Had Hearn been permitted to purchase the stock he claimed he was entitled to buy, the purchase would have been a capital transaction resulting in neither gain nor loss to the corporation, irrespective of the price paid therefor. *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803 * * *.
>
> *As was pointed out in the Simmons case, the only result so far as the corporation is concerned is a change in the capital structure.* (Italics supplied.)

The Second Circuit, in affirming the Board, said (p. 851) that

> * * * there was nothing more than a distribution of assets to a minority stockholder to preserve the existing stockholding ratio of two to one between the two sole owners of the corporation. *It was merely a matter affecting the capital structure of a corporation* * * *. (Italics supplied.)

In *Riggs National Bank* (1929), affirmed 57 F. (2d) 980 (1932), the Board said: "The Board had also decided that a corporation derived no taxable gain and sustained no deductible loss by reason of dealings in its own stock."

In *J. H. Johnson* (1930), *supra*, affirmed 56 F. (2d) 58, the Board said:

> The amount paid to Davis by the Barr-Davis Oil Co. for his stock was clearly no part of the cost of the oil and gas lease the company had theretofore acquired. Nor was it a loss to the company. It was a capital transaction that amounted to a distribution to Davis of part of the company's assets which did not result in gain or loss to the company. *Simmons & Hammond Mfg. Co.*, 1 B. T. A. 803.

The Fifth Circuit Court of Appeals in affirming the Board, 56 F. (2d) 58, said:

> Argument is unnecessary to demonstrate that what was paid to Davis for his stock added nothing to the actual cost of the assets. The Treasury Department has always ruled that a corporation receives no gain or loss from the purchase of its own stock. See article 543, T. R. 62 (1921). *This is a reasonable and logical ruling and may be considered to have congressional approval by the enactment of subsequent revenue laws without any attempt to change it. The Board of Tax Appeals has consistently followed this ruling, holding such purchases to be capital transactions, amounting to a distribution of the stockholders' share of the assets.* (Italics supplied.)

Certiorari was denied 286 U. S. 551 (1932).

As pointed out above (p. 14), it was in 1925 that *Borg* v. *International Silver Co.* was decided. That case sets forth fully the reason underlying the Treasury Regulations and Decisions, and the decisions of the Board.

Later the same Court had under consideration *Founders General Corp'n* v. *Com'r*, 79 F. (2d) 6, 8, wherein a subsidiary sold stock of the parent. In an opinion, concurring in part and dissenting in part, Judge L. Hand again succinctly states the underlying principle:

> *When a company issues shares, it makes the holder a member of the group of shareholders; when it buys them, this member retires from the group and takes his share of the assets.* Assuming that he gets no more than his shares are worth at that moment, the group, i. e., *the corporation, has neither lost nor gained.* That is the naive view and *the right view,* freed from fictions; *and it is the view of the regulations.* Article 66, Regulations 74. (Italics supplied.)

The above reference *is to the very Article of the Regulation* (Reg. 74, Art. 66) *which is under consideration in the instant case.*

In *United Drug Co.* v. *Nichols,* 21 F. (2d) 160 (1927), the Court proceeded on the theory of consolidated unity between affiliated corporations, and said:

> The entire proceeds from the sale of this stock represented additional capital to the affiliated group—the investment of the new stockholders who purchased the stock. The sale was a capital transaction, which could not give rise to a taxable gain or deductible loss. Appeal of Farmers Deposit National Bank, 5 B. T. A. 520.

Thus it is seen that the rule was being urged by the Department in the Board and in the Courts over a long period of years; and that contemporaneously with the Departmental Regulations, and in accordance with Departmental Regulations, Decisions and Rulings, the Board and the Courts, over this same period of years, were giving affirmation and approbation to the rule.

There is Reason in Support of the Rule.

Under the Supreme Court Rule it is necessary for the Commissioner, in order to sustain his present position, to establish that the rule adhered to, for these many years, by the Treasury Department, the Board and the Courts, is clearly and plainly wrong and without reason to support it, and that its overthrow is plainly required.

Like many other terms of general purport, "reasonableness" is a comparative term.

It stands to reason that if the rule were devoid of reason, were plainly and clearly wrong, and were utterly untenable,

some one among the various Secretaries, Commissioners, General Counsels, Appeals and Reviews Committees, Legislative Committees, Board of Tax Appeals, and Circuit Courts of Appeals, would have been able to detect it. A rule which has had over 25 years support by text writers and technical authorities, and which has had about 25 years of Departmental approval and application, and over 10 years of approval and application by the Board and the Appellate Courts, can not be said to be "plainly and clearly wrong." The error was not plain or clear enough for detection by the many Administrators and Judges who gave study to the question during those many years.

The Rule was open, notorious, and well recognized for many years. The Regulations and Decisions of the Treasury Department were published. The Decisions of the Board and of the Courts were published. Congress is deemed to know the official construction put upon statutes especially when such constructions are of long and well recognized standing. It was in light of such long and well recognized standing that Congress reenacted the statute without change. In light of Departmental Regulations and Decisions the statute was so reenacted seven times. In light of the authoritative text writers the statute was so reenacted at least seven times. In light of Board and Court decisions on this specific point (beginning in 1925[1]) the statute was so reenacted four times without change.

The Long Established Doctrine of the Supreme Court is Applicable under the Circumstances.

The doctrine applicable under the circumstances has been applied by this Court since 1827 (*Edwards* v. *Darby*, 12 Wheat. 206, 210). The doctrine is grounded on the principle that there should be certainty and repose in matters long since settled. The principle is aptly stated in *Com'rs of Inland Revenue* v. *Harrison*, L. R. 7 H. L. 1:

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[1] *Borg* v. *International Silver Co., supra; Simmons & Hammond Mfg. Co., supra; Cooperative Furniture Co., supra; Atlantic Carton Co., supra.*

> The object must be, above that of all other acts, to maintain them and to expound them in a manner which will be consistent, and which will enable the subjects of this country to know exactly the charge and burden which they are to sustain. I think that, with regard to statutes of that kind, above all others, it is desirable, not so much that the principle of the decision should be capable at all times of justification, as that the law should be settled, and should, when once settled, be maintained without any danger of vacillation or uncertainty.

The doctrine has been emphasized by this Court in the variety of ways in which it has been expressed.

The most recent expression of the Court was only a month ago.

Com'r v. *Winmill*, —— U. S. —— (Nov. 7, 1938), involved the interpretation of sec. 23 (a) of the 1932 Act, a section general in its terms allowing expense deductions. Regulations provided that commissions paid in purchasing securities are a part of the cost of the securities. Taxpayer contended that such commissions were deductible as ordinary expenses. The Court said:

> Regulations promulgated under the 1916 income tax law treated commissions in security purchases as a part of the securities' cost and not as ordinary expense deductions. *This interpretation has consistently reappeared in all regulations under succeeding tax statutes.** In the period since 1916 statutes have from time to time altered allowable deductions, *but it is significant that Congress substantially retained the original taxing provisions on which these regulations have rested.*
>
> *Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law.* (Italics supplied.)
>
> * [Footnote by the Court.] Art. 293 of T. R. 45 (1918), 62 (1921); Art. 292 of T. R. 65 (1924), 69 (1926); Art 282 of T. R. 74 (1928), 77 (1932); Art. 24-2 of T. R. 86 (1934), 94 (1936).

The *Winmill case* is nicely in point and rules the instant case. In *United States* v. *Alabama Great Southern R. Co.*, 142 U. S. 613, the Court said:

> We think the contemporaneous construction thus given by the executive department of the Government, and continued for nine years through six different administrations of that department * * * should be considered as decisive in this suit. It is a settled doctrine of this court that, in case of ambiguity, the judicial department will lean in favor of a construction given to a statute by the department charged with the execution of such statute, and, *if such construction be acted upon for a number of years, will look with disfavor upon any sudden change*, whereby parties who have contracted with the Government upon the faith of such construction may be prejudiced. *It is especially objectionable* that a construction of a statute favorable to the individual citizen should be changed in such manner as to become retroactive. * * *. *These principles were announced as early as 1827 in Edwards* v. *Darby*, 25 U. S. 12 Wheat. 206, 210 [6 : 603, 604], *and have been steadily adhered to in subsequent decisions.* (Italics supplied.)

The foregoing language is quoted with approval in *Luckenbach Steamship Co.* v. *United States*, 280 U. S. 173.

In *Brewster* v. *Gage*, 280 U. S. 327, the Court was discussing a Regulation defining the basis for ascertaining a profit on a sale. The Court said:

> The Revenue Act of 1918 and subsequent acts taxed incomes of estates during the period of the administration including profits on sales of property. * * *
>
> Treasury Regulations under the revenue acts in force between 1917 and 1928 declared that value at time of the death of decedent should be taken as the basis for ascertaining profit or loss from sale of property acquired by bequest or descent * * *.
>
> These regulations were prepared by the department charged with the duty of enforcing the acts. The rule so established is reasonable and does no violence to the letter or spirit of the provisions construed. *A reversal of that*

construction would be likely to produce inconvenience and result in inequality. It is the *settled rule* that the *practical* interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration *will not be disturbed except for weighty reasons.* [Citing cases.] * * *

The substantial re-enactment in later acts of the provision theretofore construed by the department *is persuasive evidence of legislative approval of the regulation.* [Citing cases.] *The subsequent legislation confirmed and carried forward the policy evidenced by the earlier enactments as interpreted in the regulations promulgated under them.* (Italics supplied.)

In *Copper Queen Consol. Min. Co. v. Arizona*, 206 U. S. 474, Mr. Justice Holmes states the rule thus:

> And again, when, for a considerable time, a statute notoriously has received a construction in practice from those whose duty it is to carry it out, and afterwards is reenacted in the same words, it may be presumed that the construction is satisfactory to the legislature, unless plainly erroneous, since otherwise naturally the words would have been changed.

In *United States v. Cerecido Hermanos y Compania*, 209 U. S. 337, the Court repeats the rule:

> We have said that, when the meaning of a statute is doubtful, great weight should be given to the construction placed upon it by the department charged with its execution. * * * *And we have decided that the reenactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction.* (Italics supplied.)

McCaughn v. Hershey Chocolate Co., 283 U. S. 488, is aptly in point. The Court said:

> *Possible doubts as to the proper construction of the language used should be resolved in the light of its administrative and legislative history.* * * *
>
> The administrative construction was upheld in 1922 by

> Malley *v.* Walter Baker & Co. (C. C. A. 1st) 281 Fed. 41, supra, the only case, other than the present, which has considered it. The provision has been consistently enforced as construed, was re-enacted by Congress in the 1921 Act, and remained on the statute books without amendment until its repeal. Such a construction of a doubtful or ambiguous statute by officials charged with its administration will not be judicially disturbed except for reasons of weight, which this record does not present. [Citing cases.] *The re-enactment of the statute by Congress, as well as the failure to amend it in the face of the consistent administrative construction, is at least persuasive of a legislative recognition and approval of the statute as construed.* (Italics supplied.)

Massachusetts Mutual L. Ins. Co. v. *United States*, 288 U. S. 269, involved a regulation promulgated under sec. 245 of the 1921 Act. The regulation was carried forward under two succeeding revenue acts which were enacted without change. The Court said:

> It [Government] further points to a regulation adopted immediately upon the passage of the Act of 1921 and carried forward in the regulations under the Acts of 1924 and 1926. This regulation is: * * *
>
> The Congress in the Revenue Acts of 1928 and 1932 reenacted §245 without alteration. This action was taken with knowledge of the construction placed upon the section by the official charged with its administration. *If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute* [citing cases] unless, perhaps, the language of the act is unambiguous and the regulation clearly inconsistent with it. (Italics supplied.)

In *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 322, the Court said:

> Doubts, if any, whether the statute authorizes depletion of bonus payments, have been definitely set at rest by the

repeated re-enactment, without substantial change, of the provisions of §234 (a) (9), since the promulgation of treasury regulations providing for such depletion.

In *National Lead Co.* v. *United States*, 252 U. S. 140, the Court said:

> During all the intervening twenty-four years this rule of the Department with respect to drawbacks had been widely applied to many articles * * *. *The reenacting of the drawback provision four times, without substantial change*, while this method of determining what should be paid under it was being constantly employed, *amounts to an implied legislative recognition and approval of the executive construction of the statute * * * for Congress is presumed to have legislated with knowledge of such an established usage of an executive department of the government.* (Italics supplied.)

In *Universal Battery Co.* v. *United States*, 281 U. S. 580, the Court said:

> *This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong.* (Italics supplied.)

In *United States* v. *Farrar*, 281 U. S. 624, the defendant was indicted as a *purchaser* of liquor, under the Prohibition Act. The Court said that:

> * * * during * * * a period of ten y[illegible]ecutive departments charged with the administration * * * of the act have uniformly construed it as not including the purchaser * * *; no prosecution until the present one has ever been undertaken upon a different theory; and Congress, of course well aware of this construction and practice, has significantly left the law in its original form.

In *United States* v. *Jackson*, 280 U. S. 183, Mr. Chief Justice Taft stated the rule clearly and succinctly:

> It is a familiar rule of statutory construction that great weight is properly to be given to the construction consistently given to a statute by the Executive Department charged with its administration [citing cases]; *and such construction is not to be overturned* unless *clearly* wrong, or unless a different construction is *plainly required*. (Italics supplied.)

In *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, the regulations prescribed a formula for computing invested capital. The Court said that the regulations were made pursuant to express authority in the Revenue Act, that they were entitled to respectful consideration, and that they "*will not be overruled except for weighty reasons.*"

The following cases are deserving of especial consideration because of their great similarity in point of fact with the instant case.

Old Colony R. Co. v. *Com'r*, 284 U. S. 552, is particularly apt since the regulation there in question bore upon the same section of the act as herein—the general definition of gross income. The Regulations had for a long time construed the section to mean that the net amount of premium at which bonds were issued was gain which should be amortized over the life of the bonds. The Commissioner attempted to change his construction. This Court denied his right to do so, saying:

> *The regulations state that the net amount of premium is gain or income. Necessarily, then, the premium is gain or income of the year in which it is received. The provisions of the Revenue Acts of 1918, 1921, 1924 and 1926 are the same as respects gross income of corporations and deductions therefrom. The regulations under the relevant sections of the acts of 1918, 1924 and 1926 employ substantially the same phraseology as that found in those issued under the 1921 act.* The repeated reenactment of a statute without substantial change may amount to an implied legislative approval of a construction placed upon it by executive officers. (Italics supplied.)

The Court then added:

> If there were doubt as to the connotation of the term, and another meaning might be adopted, the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer [Citing *Gould* v. *Gould*, 245 U. S. 151, and several other cases to the same effect.]

The close analogy of the above case should make it controlling.

Helvering v. *Bliss*, 293 U. S. 144, is also in point with the instant case. It deals with the construction of the sections defining income, relates to the year 1928, and involves the same statute as is here involved.

In that case, as in the instant case, the sections of the statute defining income had remained substantially unchanged through several reenactments of the statute. The taxpayer argued that capital gains should be excluded from the income upon which is to be calculated the deductibie percentages of charitable contributions. The Commissioner argued that the rulings and practice of the Bureau from 1917 to 1932 had consistently allowed deductible percentages for charitable contributions against all of taxpayers' net income including capital gains, and that the reenactment of the statutes without substantial change had approved and adopted that construction. The Court concluded that the Commissioner's rulings were tenable and had support in reason and said:

> Moreover, from 1923 to 1932 the Commissioner uniformly ruled that the deduction for charitable contributions was to be taken from net income before computation of the tax and hence in whole from ordinary net income. The reenactment in later Acts of the sections permitting the deduction indicates Congressional approval of this administrative interpretation.

In the *Bliss* case the *Government* made the same argument *to the Supreme Court* which the *petitioner* is now making to this Court, and insisted upon the application of the principle for

which the instant petitioner contends. The Supreme Court sustained and approved the Government's position there and its opinion and decision thereby sustain and approve the same position here taken by the petitioner.

Old Mission P. Cement Co. v. *Helvering*, 293 U. S. 289, is also in point. There a corporation contended for a deduction on account of charitable contributions. The Commissioner contended that Departmental Regulations (Art. 562 of Reg. 62) provided to the contrary and that this regulation was retained in subsequent regulations promulgated under succeeding revenue acts. The Court said:

> The privilege of deducting charitable donations from gross income, conferred on individual taxpayers by §214 (a) of the Revenue Acts of 1921, 1924 and 1926, has not been extended to corporations. * * * Section 234 (a) (1) of the Revenue Acts of 1921, 1924 and 1926, authorizes corporations to deduct from gross income "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Article 562 of Treasury Regulations 62, interpretative of the 1921 Act, declared that corporations were not entitled to deduct charitable donations. * * * *These provisions were retained, without substantial change, in the regulations promulgated under the 1924, 1926 and 1928 Acts.* Art. 562 of T. R. 65, 69; Art. 262 of T. R. 74. As §234 (a) (1) to which they pertain has been reenacted in several revenue acts, *the regulation now has the force of law.* (Italics supplied.)

In *Hartley* v. *Com'r*, 295 U. S. 216, the question was the basis for determining gain or loss on the sale of property by a decedent's estate, whether date of acquisition of the property by the executor, or date of death of decedent. Abstractly there appeared to be doubt as to the answer. The Court said:

> Possibility of doubt was removed by treasury regulation. Article 343 of Regulation 45, under the 1918 Act, prescribed that gains or losses of an estate should be computed on the basis of the value of the property at the date of the

decedent's death. This was carried forward by Art. 343 of Reg. 62 under the Act of 1921, of Reg. 65 under the Act of 1924, and of Reg. 69 under the Act of 1926. * * * The substance of the regulation in its original and final form was carried into §113 (a) (5) of the Revenue Act of 1928, chap. 852, 45 Stat. at L. 791, 819, U. S. C. title 26, §2113, * * *.

The reenactment of the pertinent provisions of §202 of the Revenue Act of 1921 in the Acts of 1924 and [February, 1926] 1926 [44 Stat. at L. 11, chap. 27, U. S. C. title 26, §933], without material change, was a congressional recognition and approval of the interpretation of the section by the treasury regulations, which gave them the force of law. [Citing *Old Mission case, supra,* and *Brewster* v. *Gage, supra.*]

In *McFeely* v. *Com'r*, 296 U. S. 102, the question was the basis for determining a profit on the sale of property acquired from a decedent. The Court said:

The Commissioner has heretofore administered the section upon this theory. As respects the Revenue Act of 1921, he so ruled in 1923 [I. T. 1600, C. B. II-1, 36; I. T. 1719, C. B. II-2, 45] and again in a very full memorandum in 1924 [I. T. 1889, C. B. III-1, 70; O. 1012, 2 C. B. 34; P-H Tax Service, 1923, 2703-4] * * *. The repetition of the definition without material change in the subsequent acts, *including that of 1928,* amounts to a confirmation of the administrative interpretation. *There is nothing in the section, its history, or the administrative practice, to enlarge or alter the connotation commonly ascribed to the word 'held.'* * * *

No change was made in the phraseology of §101 (c) (8) from that used in prior acts defining capital assets as "property held by the taxpayer * * * for more than two years." * * * The Committee Reports disclose no purpose to alter the rule laid down in the earlier statutes and reenacted in §101 (a) (8). Congress must be taken to have been familiar with the existing administrative interpretation. (Italics supplied.)

The foregoing case presents a case where the Commissioner

was attempting, as in the instant case, to apply a different rule from that followed persistently for a long period.

In *Koshland* v. *Helvering*, 298 U. S. 441, the Court said:

> * * * We give great weight to an administrative interpretation long and consistently followed, particularly when the Congress, presumably with that construction in mind, has reenacted the statute without change [citing *Poe* v. *Seaborn*, 282 U. S. 101, 116; *McCaughn* v. *Hershey, supra; McFeely* v. *Com'r, supra*] * * *.
>
> * * * Where the act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts. *And the same principle governs where the statute merely expresses a general rule*[1] and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. (Italics supplied.)

Two members of the Court dissented from the *decision* in that case but indicated their views on the subject-matter here under discussion, as follows:

> The meaning of the Act of Congress * * * has had a practical construction through administrative action and legislative acquiescence. *Even though the meaning may have been uncertain in the beginning,* it has now become fixed in accordance with long continued practice. *Morrissey* v. *Commissioner*, 296 U. S. 344, 355; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378, 384. (Italics supplied.)

The doctrine is aptly summarized in *United States* v. *Finnell*, 185 U. S. 236. There a clerk had been paid commissions for services over a period of years and then the Treasury Department sought to change the basis of his compensation. The Supreme Court held that this could not be done, *even though originally the question might have been a doubtful one,* saying (p. 244):

[1] As noted *supra*, Sec. 22 (a) is expressly stated to be a "*General definition.*"

> * * * Of course, if the departmental construction of the statute in question were obviously or clearly wrong, it would be the duty of the court to so adjudge. * * * But if there simply be doubt as to the soundness of that construction,—and that is the utmost that can be asserted by the government,—the action during many years of the Department charged with execution of the statute should be respected, and not overruled except for cogent reasons.

One of the most exhaustive discussions of this principle is found in *Walker* v. *United States* (C. C. A. 8, 1936), 83 F. (2d) 103. In that case a regulation of long standing was in force at decedent's death. Thereafter the Commissioner promulgated a new regulation entirely contrary to the former one, and contended that the former regulation was plainly wrong. The Court reviewed the history and logic of the principle here involved and said:

> The weight or force which the courts will * * * give to such executive or legislative construction, has been variously phrased by the Supreme Court. Similarly, there is a variety of expression as to such weight and force where the court conceives the executive construction to be also approved by Congress. In such latter situation, it has been said that the executive construction has the "force of law" [citing cases]; that it "must be accepted" [citing cases]; that it "will not be overturned except for very cogent reasons" [citing cases]; that it would be given "great weight, *even if we doubted the correctness of the ruling*" [citing cases]; that it will not be "disturbed except for reasons of weight" [citing cases]; that "were the matter less clear" the court "should be constrained" to follow it [citing cases]; that it will be followed "when not plainly erroneous" [citing cases]. When the quotations in the above sentence are considered in connection with the issues and situations in which they were severally used, it would seem that a safe statement of the rule of construction is that, where a statutory provision is ambiguous, and the executive department which must apply and enforce it declares a construction (not in itself ambiguous * * *) for administrative purposes, and thereafter Congress reenacts the provision without substantial change, the courts will

accept that construction unless it be "plainly erroneous." * * * (p. 106–107.)

In applying this rule, we find an ambiguity of meaning in this respect; that the department has consistently and continuously recognized the effect of payment by the beneficiary; that the Congress has re-enacted this identical language while such departmental construction thereof was being applied in administration; that the Supreme Court has strongly intimated that the source of premiums was an element in the subjection of life insurance proceeds to such character of tax. Obviously, we can not in such situation say (nor would we do so independently thereof) that Regulation 70 is so "plainly erroneous" as a construction of the act that we should reject it. * * * (p. 109.)

* * * *But, if the courts consider themselves bound to follow executive constructions approved by congressional re-enactment unless such constructions are "plainly erroneous," it must follow that they should consider the executive similarly bound and regard such subsequent construction by the executive from that standpoint.* * * * (p. 109.)

Here, Regulations 80 is, in part, a reversal or at least a limitation of Regulations 70. * * * *At least it is clear that Regulations 80 has not revealed a standard which shows Regulations 70 to be "clearly erroneous."* The result is that the later regulation can not, under the situation here, be held to replace or change the effect of the earlier regulation; * * * (p. 109). (Italics supplied.)

The foregoing leaves no doubt as to what the rule is, or as to its application to the facts in the instant case. *Every element which was pointed to as controlling in the above case is present in the instant case.*

The Decision of the Court Below in the Instant Case Was Pursuant to the Foregoing Principle.

The Court below rendered its decision in light of the administrative and legislative history of the Regulation, and in light of the legal and technical authorities supporting it. The decision of the Court below was specifically grounded on the foregoing principles.

The Court below reviewed the authorities supporting the

long continued Treasury Regulations—the technical, the legal, and the administrative authorities. The Court found (R. bot. 73) that:

> During a period of sixteen years from 1918 to 1934, the regulations, rulings and decisions of the Treasury Department and the decisions of the Board of Tax Appeals supported the interpretation of the statute for which the taxpayer now contends. * * * Thus the regulations in force during the period expressly declare that "a corporation realizes no gain or loss from the purchase or sale of its own stock"; the rulings and decisions of the Treasury Department were in harmony with this pronouncement.

The Court further found (R. 74, and marginal notes) that the decisions of the Board of Tax Appeals were likewise in harmony therewith.

The Court further found (R. 74) that writers upon the theory of accounting have given much consideration to the proper method of treating such transactions and that it is quite generally said that stock purchased and held as treasury stock should not be treated as an asset.

The Court further noted (R. 74, note 11) that the Federal Securities & Exchange Commission ruled that the excess of the proceeds of the sale of reacquired shares of a corporation's own stock, over the cost thereof, should be accounted for as capital since a transaction of this nature does not result in profit.

The Court quoted the opinion in *Borg* v. *International Silver Co.* and noted other decisions in conformity therewith.

After thus reviewing the history and application of the Regulation, and the authorities supporting it, the Court below determined that (R. 76–77) neither interpretation of the Act is without a reasonable basis: that it is reasonable to say that when a corporation buys or sells its own stock, a change in the capital structure takes place: and that, on the other hand, it might be said that an increase or decrease of resources which accompanies such transactions bears resemblance to recognizable gain or loss. The Court concludes:

There is room for debate, and this situation determines the rationale of our decision in the pending case.

Upon the foregoing premise the Court below followed literally the mandates of this Court that: "Possible doubts as to the proper construction of the language used should be resolved in the light of its administrative and legislative history."[1] "The Commissioner has heretofore administered the section upon this theory. * * * The repetition of the definition without material change in the subsequent acts, including that of 1928, amounts to a confirmation of the administrative interpretation."[2] "It is especially objectionable that a construction of a statute favorable to the individual citizen should be changed in such manner as to become retroactive * * *."[3] "* * * the reenactment by Congress, without change, of a statute which had previously received long-continued executive construction, is an adoption by Congress of such construction."[4] "These provisions were retained, without substantial change, in the regulations promulgated under the 1924, 1926 and 1928 Acts. * * * As §234 (a) (1) to which they pertain has been reenacted in several revenue acts, the regulation now has the force of law."[5] "This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong."[6] "This interpretation has consistently reappeared in all regulations under succeeding tax statutes. * * * it is significant that Congress substantially retained the original taxing provisions on which these regulations have rested. Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes are deemed to have received congressional approval and have the effect of law."[7]

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[1] *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492.
[2] *McFeely* v. *Helvering*, 296 U. S. 102, 108.
[3] *United States* v. *Alabama Great Southern R. Co.*, 142 U. S. 615, 622.
[4] *United States* v. *Cerecido Hermanos y Compania*, 209 U. S. 337, 339.
[5] *Old Mission P. Cement Co.* v. *Helvering*, 293 U. S. 289, 293–294.
[6] *Universal Battery Co.* v. *United States*, 281 U. S. 580, bot. 583.
[7] *Com'r* v. *Winmill* —— U. S. —— (Nov. 7, 1938).

The Court below applied all of the foregoing injunctions of this Court to the circumstances herein and said:

> But, as we have seen, the prevailing opinion in that year [1918] and thence continuously until 1934 forbad the taxation of such a profit as the Tobacco Company earned in 1929 in the sale of its own stock; and Congress in light of this interpretation of its intent reenacted in substantially the same words the definition of income subject to tax in five successive carefully considered revenue acts (R. mid. 77).

Having held that the long continued construction of the Regulations and Decisions was not without a reasonable basis and was not plainly and obviously wrong, the Court below stated the rationale of its decision as follows:

> Our path is therefore clear: for the rule is well settled that if a statute is reasonably susceptible of two constructions, its reenactment after an interpretative ruling by responsible officials amounts to a legislative sanction of the course pursued. Especially is this true when the construction has been long maintained and several reenactments of the language in dispute have taken place. The rule has been frequently applied in cases under the revenue acts when the statutory language is in general terms and susceptible of different interpretation as applied to the relevant facts; and in Johnson *v.* Commissioner, 56 F. (2d) 58, (C.C.A. 5) 1932, it was applied to the very regulation now under consideration as set out in Regulations 62, Article 543 relating to the Revenue Act of 1921.

The Court below was correct in following the established rule of this Court in such circumstances.

The Instant Case Presents No Exception to the Established Rule of This Court.

Sec. 22 (a) of the 1928 Act is a *general definition*[1] of income.

[1] Sec. 22 (a) of the Act specifically so designates it.

It is not proper to classify it as "ambiguous" or as "unambiguous." As in all such general statutory definitions it is the duty of the Department to indicate the method of its application to specific cases. This Court has said that "where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations," "a clarifying regulation or one indicating the method of its application to specific cases" will be given great weight by the courts.[1] This Court has also said that where the Department has long continued to administer a general definition by specific construction, such construction must not be altered unless the section, its history, and the administrative practice, shows it to be violative of the plain and unequivocal meaning of the statute.[2] This Court has held that possible doubts as to such construction must be reviewed in the light of its administrative and legislative history.[3]

Sec. 22 (a) being a "general" definition, the Secretary construed it under the power with which he was invested so to do. The foregoing rule of this Court is specifically applicable.

The Decision Below is Supported by the Recent Decision in the Squibb Case.

On July 12, 1938, the Circuit Court of Appeals for the Second Circuit rendered a decision in *E. R. Squibb & Sons* v. *Helvering*, 98 F. (2d) 69. To the extent the shares therein were reaquired and reissued at the open market price, the facts of that case are similar to those herein. That case arose under sec. 22 (a) of the 1932 Act which is identical in terms with sec. 22 (a) of the 1928 Act. The Regulations under the two Acts were likewise identical.

In that case the Court discussed at length the soundness of the long continued regulations and decisions, and demonstrated

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[1] *Koshland* v. *Helvering*, 298 U. S. 441, 447, 446. Cf: *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 349, 350.

[2] *McFeely* v. *Helvering*, 296 U. S. 102, 108; also *Com'r.* v. *Winmill*, *supra*.

[3] *McCaughan* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492.

that they were supported by logic and reason and that their interpretation of the statute was at least permissible.

That discussion by the Court is enlightening and persuasive, and for the convenience of this Court the decision in that case is set forth in Appendix B, *infra* pp. 70.

The conclusion of the Court is: (1) the long continued regulations were not untenable but were permissible as reasonable: (2) they had received an authoritative interpretation through the long acquiescence of Congress and repeated reenactments of the statute without change: and (3) the changed regulations are not applicable to the instant transactions which did not constitute a dealing in its own shares as it might in the shares of another corporation.

The Court concluded that "the uniform interpretation, so long placed upon §22 (a), * * * by the regulation and confirmed by the inaction of Congress, was imbedded in the statute so deep that only legislation could dislodge it."

The decision in the *Squibb case* is in accord with the rule of this Court. It is logical and persuasive, and supports the decision in the instant case.

The Recent Decision in the Case of First Chrold Corporation is Not Persuasive.

On May 26, 1928, the Circuit Court of Appeals for the Third Circuit decided the case of *First Chrold Corp'n v. Com'r*, 97 F. (2d) 22. In that case the Court did not pass upon or decide the issue presented in the instant case, viz: whether the long continued interpretation put upon the statute by the regulations and decisions should be overthrown.

The Court approached the question by stating: "We treat the case as presenting but one question." The Court then stated the question to be whether or not a corporation realized a taxable profit when it acquired shares of its own stock and reissued them for a price above the acquisition price. The Court treated the case as one of first impression, ignoring the fact that it was not a case of first impression. The Court made no mention of the Regulations, existing since 1918, upon which

the taxpayer relied in making its transaction. The Court made no mention of the many Departmental Rulings and Decisions applying that regulation. The Court made no mention of the authorities, cases and decisions tending to show that there was reason, logic and authority to support that construction. The Court did not decide or hold that the old and long continued construction was clearly and obviously wrong and untenable.

That decision held only one thing. It held only that, viewed as a matter of first impression, shares of stock are *thought of* as property, because shares can be bought and sold: that a corporation may buy and sell its own shares as it does other kinds of property, in a *practical* sense: that in such case it ignores the fact that it is its own stock: that this is so because corporations are known to do it: that when a corporation buys and sells its own stock it constitutes an "as if" transaction. i. e., in such cases the corporation buys and sells them "*as if*" *they were not the corporation's own shares.* The Court concludes that this in no way affects the capital of the corporation because it is assumed that, if the shares were not the corporation's own shares, the transaction would be taxable, but since they *were* the corporation's own shares, they would, notwithstanding, be considered "as if" they *were not.* The Court cites no authority for its view The Court, in effect, says that, as an abstract proposition of first impression, such a transaction ought to be taxed.

It is not necessary here to decide whether the above decision would have been abstractly correct if it had been decided in 1918. Neither is it necessary to decide here whether the decision below in *the instant case* would have been abstractly correct if it had been decided in 1918.

The instant case was decided by applying the rule of this Court in light of administrative, legislative and political history as it exists to-day.

The *Chrold case* was not decided on that basis and is not persuasive on the issue presented herein. (See Respondent's Brief in Opposition to Certiorari, pp. 1–2, 15–17, 19–20.)

A Construction of a Statute Should Not Be Adopted which Leads to Unjust, Oppressive or Inconsistent Results, and Which Does Violence to the Rule of Uniformity of Taxation.

The instant petition for certiorari states that there are six similar cases pending in the Board and at least eighteen in the Bureau. The taxpayer does not have the advantage of statistics but respectfully suggests to the Court the following:

For about 25 years the Commissioner administered this section under his rulings that the instant transactions were capital transactions and not income transactions. For 16 years of that time his Regulations so provided. During about 10 years of that period he maintained and defended that position in the Board of Tax Appeals and in the Courts, in a large number of cases. During that period the statute was repeatedly reenacted without change. Obviously every tax case in which this principle was applied was not made the subject of a published Departmental ruling or Board decision. It is reasonable to suggest, therefore, that his long continued construction has been applied to thousands of cases: that thousands of taxpayers have had their taxes adjusted by the Commissioner under those regulations and rulings: that other thousands of taxpayers made their returns in accordance with those regulations and no tax case arose upon them. The cases of all those thousands of taxpayers are now closed. By applying his construction over this long period of years the Commissioner has unquestionably collected vast amounts of money in taxes.

The Commissioner now seeks to apply *retroactively* an opposite rule. He seeks to apply such opposite rule retroactively to 1924. That is now a period of 14 years. His petition says there are now about 24 cases. This is an average of slightly less than two cases per year since 1924.

The retroactive change of construction contended for by the Commissioner would violate a long established doctrine of this Court relative to uniformity of taxation. According to the petition herein a very negligible fraction of taxpayers' cases, which have arisen on this point since 1918, are now involved.

Practically all of them are finally closed by the statute of limitations. It would be unjust and oppressive to the remaining few to apply a rule totally opposite to, and inconsistent with, the rule applied to practically all the similarly circumstanced taxpayers through all these years of the administration of the section in question.

The present attempt of the Commissioner to collect taxes from one group of taxpayers on one basis, and from another group similarly circumstanced on another basis, does not present the case of a sporadic or inadvertent mistake on his part, which the Court will not view as deliberate. On the contrary, his interpretation and application of one rule of construction has been studied, deliberate, uniform and consistent over a period of many years. His attempt now to change that rule and apply such change retroactively to a small group of taxpayers whose transactions were made in the light of his former construction, is deliberate and not inadvertent. It is a studied attempt to apply a different rule of taxation to a small remaining group of taxpayers.

The courts have uniformly felt strongly and talked plainly about such discriminations and lack of uniformity, by taxing authorities, between taxpayers similarly circumstanced. They have withheld judicial rectification of such discriminations only when they have been shown plainly to be accidental and inadvertent, and to have come about without the design or intent of the taxing authority. But where the discrimination complained of is shown to be the result of knowing, conscious and deliberate action on the part of the taxing authority, where the discrimination is shown to be the result of the application by the taxing authorities of two different rules, principles, or standards, and thus to be inescapably due to design and intent on the part of the taxing authorities;—under such circumstances the courts have consistently refused to countenance such action and have, when necessary, relieved against such discrimination.

And even where it is unmistakably shown that the rule, principle, standard or method applied to one group of taxpayers

is doubtful, erroneous, unlawful and not in accordance with the statute, the courts have not hesitated to correct an intentional discrimination by applying the same rule, principle, standard or method to another group of taxpayers. The intentional misuse of the taxing power to bring about inequality of tax burden between citizens has so outraged the Anglo-Saxon sense of justice that the courts have destroyed such inequalities or refused to permit them to be perpetrated, even though they had to override the abstractly plain words of a taxing statute to do so.

The rule against discriminations, inequality, lack of uniformity, and unjust and oppressive results has been repeatedly stated. *United States* v. *Kirby*, 7 Wall. 482, 486; *Ilfeld Co.* v. *Hernandez*, 292 U. S. 62, 68; *Savings and Loan Ass'n* v. *Topeka*, 20 Wall. 655; *Reagan* v. *Trust Co.*, 154 U. S. 362, 390; *Sioux City Bridge Co.* v. *Dakota County*, 260 U. S. 441; *Ozawa* v. *United States*, 260 U. S. 178, 194; *United States* v. *Alabama Great Sou. R. Co.*, 142 U. S. 615, 622; *Brewster* v. *Gage*, 280 U. S. 327, bot. 336; *Taylor* v. *L. & N. R. Co.*, 88 Fed. 350; *Railroad and Telephone Cos.* v. *Board*, 85 Fed. 302, bot. 307; *County of Santa Clara* v. *Railroad Co.*, 18 Fed. 385, 399; *Louisville & N. R. Co.* v. *Bosworth*, 230 Fed. 191, 209; *State* v. *Taylor*, 35 N. J. Law 184; *People ex rel.* v. *City of Chicago*, 152 Ill. 546, 552; *Supervisors* v. *Railroad Co.*, 44 Ill. 229; *Ex parte Bridge Co.*, 62 Ark. 461; *Com'rs of Inland Revenue* v. *Harrison*, L. R. 7 H. L. 1; Lewis' Sutherland Statutory Construction, Vol. 2 (2d Ed. 1904), sec. 489, p. 913.

In *Bingham* v. *United States*, 296 U. S. 211, this Court quoting with approval from *Lewellyn* v. *Frick*, 268 U. S. 238, said:

> This court applied the rule that acts of Congress are to be construed, if possible, so as to avoid grave doubts as to their constitutionality; and said that such doubts were avoided by construing the statute as referring only to transactions taking place after it was passed. In that connection we invoked the general principle "that the laws are not to be considered as applying to cases which arose before their passage" when to disregard it would be

to impose an unexpected liability that, if known, might have been avoided by those concerned.

And in *United States* v. *Flannery*, 268 U. S. 98, this Court said that: "Decisions affecting the business interests of the country should not be disturbed except for the most cogent reasons."

In *United States* v. *Kirby, supra*, it was said: "*General terms should be so limited in their application as not to lead to injustice, oppression, or an absurd consequence.*" In *Ilfeld* v. *Hernandez, supra*, it was said: "If allowed, this would be the practical equivalent of double deduction. In the absence of a provision of the Act definitely requiring it, a purpose so opposed to precedent *and equality of treatment of taxpayers* will not be attributed to lawmakers."

In *Brewster* v. *Gage, supra:* "The rule so well established is reasonable and does no violence to the letter or spirit of the provisions construed. *A reversal of that construction would be likely to produce inconvenience and result in inequality.*" In *United States* v. *Alabama Great Sou. R. Co., supra*, it was stated that the judiciary leans in favor of departmental construction and that "*if such construction be acted upon for a number of years, will look with disfavor on any sudden change,*" and that: "*It is especially objectionable that a construction of a statute favorable to the individual citizen should be changed in such manner as to become retroactive. * * **" The Court added: "*These principles were announced as early as 1827 * * * and have been steadily adhered to in subsequent decisions.*" See also *National Bank* v. *Whitney*, 103 U. S. 99, 102; *Hassett* v. *Welch*, 303 U. S. ——.

The taxpayer respectfully submits that the attempt of the Commissioner to invalidate retroactively his Regulations and Rulings of many years standing would result in unjust, oppressive, and inconsistent results, would do violence to the rule of uniformity of taxation and would work a discrimination as between taxpayers similarly circumstanced.

The decision of the Court below in the instant case is in conformity with all the principles discussed hereinabove, and should be affirmed.

RESPONDENT'S ANSWER TO PETITIONER'S BRIEF.

Taxpayer had prepared its brief *supra* before receiving copy of the Government's brief and here appends its answer thereto.

The Instant Transaction Did Not Give Rise to Income.

The Commissioner argues (Bf. 20–26) that because the definition of income is general it must be construed to cover this case. He quotes cases to the effect that "income" is to be given the meaning commonly understood, and as used in its ordinary and usual sense. It would appear a sufficient answer to that argument to say that for many years the proceeds from the sale of stock has been commonly understood not to represent income to the corporation issuing it. For many years it has been commonly understood by practically all the authorities, by the Treasury Department, by the Board, and by the Courts, that such was *not* its meaning. It was in light of that common understanding that Congress enacted and repeatedly reenacted the statute. The Court below found that such was the "prevailing opinion" (R. 77). See p. 41, *supra*.

Whether Congress could levy a tax upon such proceeds, as income, is at least highly debatable. Under the 16th Amendment, Congress may tax only that which is real, genuine, and actual income. Congress can not tax mere enrichment, as petitioner's brief would seem to imply. A man might pay $100 for a tract of land and bring in an oil well and tank a million gallons of oil. He is certainly enriched but he does not have taxable income. A corporation might have as its only asset a patent of nominal value, but due to public optimism as to its merits, the corporation might sell $1,000,000 worth of stock and receive the money. It is certainly enriched but it does not have taxable income. A judge of a United States Court might receive a salary which enriched him, but he was not in receipt of taxable income until Congress specifically said so. The sale, at a large profit, of property acquired before March 1, 1913, constituted an enrichment by the realization of the

appreciation before that date, but it is not taxable income. A man may perform a valuable service for a fixed compensation. When he has completed it he is enriched by an account receivable which he can sell. But if he is on a cash basis he does not have taxable income. A man might pay $100 for a share of stock in a corporation which later piled up a surplus of many millions. The corporation might issue to him (as a stock dividend) shares of stock with a market value of many thousands. He is enriched but he has no taxable income. *Eisner* v. *Macomber, supra.*

In short, neither the Congress, nor the Courts, nor the Commissioner can extend the definition of income so as to lay a tax on something which is not income. The Amendment does not extend to everything. In the *Macomber case* the Court, speaking of the Amendment, said:

> A proper regard for its genesis, as well as its very clear language, *requires also that this Amendment* shall not be extended by loose construction * * *. (Italics supplied.)

This Court has steadfastly maintained that the statutory definition of income will not be stretched to include "receipts" which do not constitute income.

The argument of petitioner that the taxpayer was in "receipt" of cash when it issued its own stock, and that it was enriched by such receipt, does not meet the issue in this case. Such cash has not commonly, ordinarily, or usually been understood to constitute income, and quite obviously Congress did not so understand it.

A Corporation Does Not Own a Proprietary Interest in Itself.

Petitioner (Bf. bot. 26–27) asserts that it "can not be said that Treasury shares are not property from the standpoint of the corporation." He cites no authority for his statement. The answer to that asservation is that *it can be so said.* The

Treasury Department has said it for years. In *A. R. R. 693, supra*, the Treasury Department said:

> Treasury stock wherever and whenever that term is used in connection with the accounts of the corporation *or for income tax purposes*, will be held to mean stock which had been previously issued by the corporation and which had been repossessed by it through purchase or otherwise, and then carried on its books as an asset. (Italics supplied.)

The same Ruling analyzed the authorities and concluded:

> * * * the transaction * * * was a capital one and *not one* in which there resulted a loss from the sale, exchange or other disposition *of property* * * *. (Italics supplied.)

In *A. R. R. 799, supra*, the exact question was whether treasury stock was an asset. The taxpayer contended it was. The Department again discussed at length the status of treasury stock in connection with the definition of "assets" and concluded that, "It will be seen that the above definition [of assets] can not include a corporation's own stock which it has *purchased* from its stockholders in the open market." (See full quotation, *supra*, p. 18.)

In addition to the foregoing, we have heretofore pointed out that (in addition to the repeated official rulings of the Department) the text writers, the Board, and the courts have said repeatedly that treasury stock is not an asset of the issuing corporation. In *Com'r v. Schoellkopf*, —— F. (2d) —— (Dec. 5, 1938), aff'g 35 B. T. A. 855, a corporation acquired shares of its own stock from another corporation in a reorganization. Taxpayer argued that the first corporation had acquired "property." The Court rejected that argument, saying:

> As to the shares we do not agree: the shares of a company, when transferred to itself, can not properly be regarded as property acquired: the shares are merely extinguished.

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A corporation can not have a proprietary interest in itself. It can not own a part of itself as a property asset.

It is clear that the unsupported assertion (that treasury stock is a property asset) is made by petitioner as a predicate for his argument relative to certain cases which are demonstrably not in point.

We have reviewed the long line of authorities holding that taxable gain is not realized by a corporation when it sells its own treasury stock.

A second group of cases, which are in no way in conflict with those above mentioned, hold that where a profit results from a sale of property, *as distinguished from the corporation's own shares*, such profit is taxable even though the buyer uses shares of the seller's stock as a medium of payment. In such cases the courts have clearly pointed out that the taxed profit is on the *sale of the property and not because of any dealing in the seller's shares*.

Such cases are those cited by petitioner in his brief, viz: *Walville Lumber Co.* v. *Com'r*, 35 F. (2d) 445; *Com'r* v. *S. A. Woods Mach. Co.*, 57 F. (2d) 635; *Com'r* v. *Boca Ceiga Dev. Co.*, 66 F. (2d) 1004; *Dorsey Co.* v. *Com'r*, 76 F. (2d) 339; and *Allyne-Zerk Co.* v. *Com'r*, 83 F. (2d) 525.

The Cases Cited by Petitioner Do Not Hold the Original Regulation Invalid as to It's Provisions that a Corporation Realizes No Gain or Loss from the Purchase and Sale of Its Own Stock.

Walville Lbr. Co., Supra, (Pet. Bf. 27) does not question the long continued regulation here under consideration. The Court did not even refer to it. In that case taxpayer had an investment of $440,000 in the M Co. The principal asset of M Co. consisted of shares of the taxpayer. M Co. was liquidated and dissolved and in that process the taxpayer received back certain shares of its own stock. It claimed a loss on the liquidation of its investment in M Co. The Commissioner

contended that the transaction resulted in a reduction of "invested capital," under a regulation relating to "invested capital." The Court held that actually the taxpayer had an investment of $440,000 *in the stock of another corporation* which constituted property in taxpayer's hands; that the liquidation of that investment resulted in a loss; and the incidental fact that the medium employed in the liquidation was in the form of taxpayer's stock, did not change the primary result. The Court reasoned that if M Co. had sold its asset (taxpayer's stock) and distributed the cash, the loss would be apparent, and the fact that the stock was surrendered in lieu of the cash did not change the result. In that case there was no point made that the taxpayer was dealing in its own stock. The decision had no such predicate, and it in no way supports an argument that the long-continued regulation here under consideration was invalid, or that the changed regulation controls in the instant case.

Petitioner cites *Woods Mach. Co., supra*, (Bf. 28) and states that in that case "it was held that the receipt of its own stock by the taxpayer corporation constituted income, the Treasury Regulations to the contrary notwithstanding." Respondent respectfully submits that that statement is erroneous and that that case held no such thing.

In that case the taxpayer collected a debt and thereby realized a profit. The debt was a judgment debt, and the debtor discharged the debt by delivering to the creditor shares of the latter's stock. The Court held that the profit was realized *on the collection of the debt*, and *not* upon the incident of the acquisition of shares of stock. The Court pointed out the distinction, saying:

> The transaction involved in this case was *equivalent to the payment of the debt in cash* and the investment of the proceeds by the corporation in its own stock. If that had been done clearly the cash received would have been taxable income. *The transaction was not changed in its essential character by the fact that, as the debtor happened also to own the stock, the money payment and the purchase of*

> *the stock were by-passed*, and the stock was directly transferred in payment of the debt. The stock was the *medium* in which the debt was paid. (Italics supplied.)

Nowhere in that decision was the long continued regulation held invalid. The Court merely held that it was not applicable. That case was first decided by the Board, 21 B. T. A. 818, 820. There the majority held that the case was ruled by *Simmons & Hammond Mfg. Co., supra*, and the existing regulations. Six dissenters contended the regulations were sound and that *Simmons & Hammond* was sound, but that *Woods Mach. Co.* did not come under that rule. The dissenters said:

> * * * The essential thing is that a liability owing to the taxpayer for the use of its property is being liquidated, and that which is received in liquidation is income. *Such is not the case* where the taxpayer buys or sells its own stock for cash, for in neither transaction is there a liquidation of a liability owing to it. * * *
>
> The real question for decision is whether petitioner realized income *as the result of the infringement of its patents and not whether gain or loss may arise out of transactions in capital stock* as the case is treated in the majority opinion. (Italics supplied.)

It will be noted that the Court adopted the view of those dissenters. That view was that the transaction was not one comparable to that in which a corporation acquires and reissues its stock for cash, and that the regulation and decisions applicable to such a transaction were not applicable in the *Woods case*.

Thus the *Woods decision* carries within itself the distinction between that transaction and the instant one. That decision is not authority for the petitioner's contentions herein.

Petitioner cites *Com'r v. Boca Ceiga Dev. Co., supra*, (Bf. 29). That case offers no support for petitioner's contention herein. There taxpayer *sold a tract of land at a profit*. The purchaser delivered shares of seller's stock as the initial payment, repre-

senting about 9% of the purchase price. The Commissioner contended that the profit, realized on the sale of land, was taxable regardless of the fact that the respondent's stock was the medium by which a part of the payment was made. It will be noted that the Commissioner was not contending that a profit was made on a transaction or deal in stock, but that the taxable profit inhered in the sale of the land. The Court took the latter view and observed that since the profit was realized on a sale of land, it was taxable regardless of the medium in which payment was made.

The Court *did not decide*, as suggested by petitioner, that a corporation's own stock was property under the circumstances. A study of that case discloses that it is not even suggested.

Petitioner cites *Dorsey Co. v. Com'r*,[1] *supra*, (Bf. 30). The decision in that case negatives the argument based upon it by petitioner. There taxpayer sold a building at a profit. A part of the consideration consisted of shares of the seller's stock. In holding the profit on the sale to be taxable, the Court said:

> It may well be that a corporation taking its cash and buying its own stock makes neither gain nor loss by the mere purchase. That is true of any purchase for cash. But when in a business exchange for its real estate it receives in part its own stock it is converting by sale a previous purchase, and if what it receives has a fair market value the gain or loss realized in the exchange must be measured and taxed. *It is not the purchase of the stock but the sale of the real estate that is regarded.* Such is the requirement of the statute. (Italics supplied.)

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[1] It should be pointed out in passing that the amount of the gain held to be taxable in the *Dorsey* and *Allyne-Zerk* cases was within the amount of cash actually received by the corporation. We think these cases are more properly explained on the ground that the distribution from the corporation to its stockholder in respect of the stock surrendered was a capital transaction not giving rise to taxable gain and that the gain has reference to the sale of the remaining property to the stockholder for cash. An analogy is afforded in the "boot" provision of Section 112 providing for non-recognition of gain. Where property, other than that in respect of which no gain or loss is recognized, is received by the transferor, the amount of gain taxable is not in excess of the "boot" received.

It is important to note that the Fifth Circuit in the *Dorsey* case saw no reason to comment upon its earlier decision denying taxability to a naked transaction by a corporation in its own stock for cash. *Johnson* v. *Commissioner*, 56 F. (2d) 58. That case involved the following facts: In February, 1921, the corporate taxpayer repurchased 2,590 shares out of a total of its 7,500 shares outstanding, and paid therefor $104,000 in cash. In October, 1921, it sold all its tangible assets (excluding, of course, the treasury stock), for an amount in excess of their cost and went out of business. After the sale the stockholders took corporate action to liquidate and dissolve, and a trustee in liquidation was appointed. The sale was upon deferred payments, and the profit thereon was taxable in 1921 and 1922. The Commissioner brought transferee proceedings against stockholders, who asserted two grounds for there being no profit on the sale. The first was that the amount paid to repurchase its own stock went to increase the cost of the real assets of the corporation. Obviously, this was untenable. The second contention was that the amount paid to repurchase stock was a loss in 1921 when the repurchase was made, or in 1922 (7th assignment of error, R. 44). The petitioner's contention was stated in his petition for review (p. 19) as follows:

> But when the corporation disposes of its assets and goes out of business the value of the capital item is gone and it has been held that in that year the amount so expended constitutes a deductible loss.

The *Commissioner* argued that the amount paid in purchase of the treasury stock was a distribution to stockholders in a capital transaction, and said at page 19, ff., of his brief:

> The statutes, however, make no provision for recognizing gain or loss on such *stock* transactions for the reason, of course, that they affect the capital structure of a corporation while those of bonds do not. Moreover, the interpretive regulations have consistently so held, and since successive taxing statutes have made no change therein, legislative approval is imported. * * *

The statutes make no provision for deduction of premiums paid by a corporation in the acquisition of its own stock, and the Commissioner's regulations provide that "a corporation sustains no deductible loss from the sale of its capital stock" (see Art. 563, Regs. 45, 62, 65, and 69; Art. 66, Reg. 74), and, conversely, "A corporation realizes no gain or loss from the purchase of its own stock," as in the instant case (Reg. 62, Art. 543, *supra;* see also Art. 543, Regs. 45, 65, and 69; Art. 66, Reg. 74). It is submitted that, as this Court aptly stated in connection with a regulation in *Taylor Oil & Gas Co.* v. *Commissioner* (C. C. A. 5th), 47 F. (2d) 108, 109. "This is a reasonable regulation, and should be given effect. *Universal Battery Co.* v. *U. S.*, 281 U. S. 580." It is settled that administrative construction is not to be overruled unless plainly wrong. *Universal Battery Co.* v. *United States*, 281 U. S. 580, 583; *Fawcus Machine Co.* v. *United States*, 282 U. S. 374, 378. The later Revenue Acts have been similarly construed by the Commissioner and the failure of Congress to enact legislation disapproving the administrative construction imparts legislative approval thereof. *Brewster* v. *Gage*, 280 U. S. 327, 337; *Poe* v. *Seaborn*, 282 U. S. 101, 117; *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 492.

It is obvious that the purchase of Davis' stock affected only the capital structure of the Oil Company, and that it had no relation to the operation of the business or to the company's current income. Just as a sale of capital stock increases the amount of capital available for business purposes, so, conversely the purchase of treasury stock reduces that working capital, and diminishes the sum available for distribution to other stockholders. Whether it was advisable for the stockholders, in the present case, to accept a diminution in their equitable interests in order to eliminate a dissentious stockholder, was entirely a matter of their own concern in which the government is not interested. It did not affect the income of the company which, under section 2 (2) of the Revenue Act of 1921, *supra*, was regarded as a business entity, separate and distinct from its stockholders.

While an accession of income or sustenance of a loss may be realized upon the purchase by a corporation of its own bonds according to whether acquired below or above

> the original price of issue (*United States* v. *Kirby Lumber Co., supra*), it is nevertheless equally clear that, under the law and regulations, no loss or gain can be realized by a corporation from the purchase of its own stock. The former does not involve the capital structure while the latter does.

The Court, in holding for the Government on both issues, said, at page 59:

> Argument is unnecessary to demonstrate that what was paid to Davis for his stock added nothing to the actual cost of the assets. The Treasury Department has always ruled that a corporation receives no gain or loss from the purchase of its own stock. See article 543, T. R. 62 (1921). This is a reasonable and logical ruling and may be considered to have congressional approval by the enactment of subsequent revenue laws without any attempt to change it. The Board of Tax Appeals has consistently followed this ruling, holding such purchases to be capital transactions, amounting to a distribution of the stockholders' share of the assets.

Petitioner cites *Allyne-Zerk Co.* v. *Com'r*, 83 F. (2d) 525. There taxpayer sold all of its property assets and by agreement received scme of its shares as payment medium. The profit on the sale was admitted. The Board said: "It was an ordinary sale of property for cash and other considerations, among them, the surrender for cancellation of a block of petitioner's stock." The profit was held taxable. The Court based its decision squarely on the point that property had been sold at a profit under sec. 202 (c) of the 1924 Act, and that such a profit was taxable, and that such profit can not be disregarded even though stock constituted a part of the consideration. The Court observed that the question is a close one but that the profit must be viewed as realized on the *sale of its properties*, and that what the taxpayer did with the proceeds of the sale has no bearing on the question as to whether the profit was realized.

The Court did not hold the profit to have been made in a

deal in stock. The decision does not support petitioner's argument herein.

The distinction between the cases cited by petitioner and the instant case is clearly set forth in the opinion in the *Squibb case* (*infra*, Appendix B, p. 70).

The Principle Here Involved is Fundamental and Does Not Depend on Book Entries.

Petitioner (Bf. 32–38) argues that corporations should not purchase their own shares without retiring them. He admits that generally the laws permit this to be done, but argues that accounting practice should be more uniform in the matter of recording such transactions. He argues that bookkeeping entries do not control in the question of whether or not an item is income.

Respondent has never claimed that the method of recording the instant transaction is controlling, but has insisted throughout that fundamentally such transactions are not productive of income, regardless of bookkeeping entries, and that they were so understood and considered when the 1928 Act was enacted, and had been so understood for many years prior thereto and were so understood for many years thereafter.

Petitioner's argument merely tends to raise a doubt where none apparently existed before, and further tends to support the application of the rule that where doubts exist they must be resolved in light of the long continued administrative, legislative and judicial interpretation of the Act.

The Changed Regulations Do Not Control the Instant Transaction.

At page 39 of his brief petitioner states that the changed regulation, in terms, treats the transaction here in question as giving rise to taxable income. He states: "It is not open to question that this regulation applies in terms to facts such as those here involved, and in terms governs pending proceedings involving the year here in question. The Board and the Court

below so understood, and respondent presumably does not take issue on this point."

All of the foregoing the respondent emphatically denies. Both in the Board and in the Court the respondent argued to the contrary. To the respondent it seems apparent that the very terms of the changed regulation preclude it from application to the instant facts.

The changed regulation does not purport to lay down a general rule that gain on sale of treasury stock is always subject to tax, irrespective of the circumstances surrounding the sale. Had the intention been to reach every sale of treasury stock, it could have been expressed in so many words. Whether the gain is subject to tax "depends upon the real nature of the transaction," which is to be determined from all the facts and circumstances. Obviously, the first sentence of the changed regulation limits the breadth of the Regulation but does not specify the instances for its application.

The instances giving rise to gain are specified in the remainder of the Article. The second sentence relates to original issue of stock. The fourth sentence relates to the receipt by a corporation of its own stock, (1) as consideration upon the sale of property by it, and (2) in satisfaction of indebtedness to it. The remaining specification is that when a corporation deals in its own shares as it might in the shares of another corporation, the gain, if any, is to be computed in the same manner as though the corporation were dealing in the shares of another. Synthesizing, the Article's limitation and its only possible application to sale of treasury stock would read as follows: All the facts and circumstances must lead to the conclusion that the corporation is dealing in its own shares as it might in the shares of another corporation before it can be said that the real nature of the transaction is such as to give rise to taxable gain.

In so far as the amendment to Article 66 has its origin in court decisions, rather than in zeal to raise revenue, its source may be found in the opinion in the *Woods case*, in which, it will be recalled, the Woods Company arranged for payment of a

debt to it in the form of a certain number of its own shares. The Court commented:

> Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved.

The facts of the case, and the tenor of the Court's opinion taken as a whole, make it plain that what the Court had in mind was that the transaction was in substance and effect not really a dealing in the corporation's own stock at all, except as the merest incident to a peculiarly income-producing corporate transaction.

The Commissioner, in recasting Article 66 of Regulation 74, followed the First Circuit opinion. The opinion said:

> But where * * * a corporation has legally dealt in its own stock as it might in the shares of another corporation, and in so doing has made a gain or suffered a loss, we perceive no sufficient reason why the gain or loss should not be taken into account in computing the taxable income.

With close attention to this opinion, the Commissioner promulgated his amended Regulation:

> But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another.

Thus, the genesis of the new regulation is found in the *Woods case* [1] and, as we have shown above, in that case the distinction was clearly made (by the Board dissenters) that a transaction such as the instant one was not taxable, while the transaction in the *Woods case* was taxable. The Court adopted generally the language of those dissenters, and in no place indicated that

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[1] See Petitioner's Brief, p. 49.

its opinion was intended to reach a transaction such as the instant case. The Court never indicated that an acquisition and a reissue of corporate stock for cash was a taxable transaction, or that such a transaction constituted dealing in shares of its own stock as it might in the shares of another corporation.

The other cases cited by petitioner are all to the same effect. None of them supports petitioner's statement.

Petitioner's statement that it is not open to question that this changed regulation applies in terms to the instant transaction, is refuted by the argument employed by Judge L. Hand in the *Squibb case, supra,* who said:

> We share the taxpayer's doubts as to whether it dealt "in its own shares as it might in the shares of another corporation."

Petitioner's unsupported statement is further shown to be without foundation by the many Rulings and Decisions of the Department, by the many text writers, by the Courts and by the Board. It is axiomatic that if one corporation owns *shares of another corporation,* those shares constitute a *property asset* in its hands. The authorities have held for years that treasury stock is not a property asset in the hands of the issuing corporation. It follows, therefore, that to say a corporation can deal in its own shares "as it might in the shares of another corporation," is to utter a paradox; and, when the instant taxpayer issued its own shares for cash, it was not selling property. Since it was not selling property, the transaction does not fall within any of the decisions cited by petitioner, and since the changed regulation is obviously written to reflect those decisions the transaction does not fall within the changed regulations. The changed regulations do not in terms apply to the instant transaction.

The Power of the Commissioner is Not Unlimited in the Matter of Making and Changing Regulations.

Petitioner argues (Bf. 40 *et seq.*) that the power of the Commissioner to amend regulations is practically unlimited. Obviously that is not true. The Commissioner can not enact a law or change a law. If an interpretation of a statute has by Congressional approval come to have the force and effect of law, then clearly the Commissioner can not change it by a revised regulation. To permit him to do that would be a delegation of legislative powers. The Commissioner can interpret the law, he can not change the law.

The Commissioner's views as to his own powers is more clearly expressed by him at pages 45–47 of his brief. It appears that his view is that his power to make regulations and amend them is essentially a judicial function, and that in the exercise of his judicial function he may exercise his power to amend a regulation regardless of the legislative approval given to such regulation. He seems to argue that his power in this respect is analogous to that of this Court where this Court has modified or overruled precedents involving constitutional questions under the laws (Bf. mid. 46).

We do not understand the power of the Commissioner to be so extensive. This Court has denied, even to itself, the right to overturn a regulation which by long continued application and legislative sanction has come to have the force of law. We do not understand that this Court has ever conceded a judicial power to the Commissioner in excess of the power which it may itself exercise.

In *Walker* v. *United States*, 83 F. (2d) 103, the Court said:

> The determination of the construction of the meaning of congressional acts is a judicial function. This function and duty is so entirely and purely judicial that it is beyond the power either of the executive[1] [citing cases] or of the Congress [citing cases] to control.

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[1] The Commissioner is an official in the executive branch, and not in the judicial branch, of the Government.

The almost limitless powers claimed for the Commissioner, in his brief, would in effect comprise both legislative and judicial functions.

Petitioner further argues that the long continued construction and repeated reenactments of the statute in light of former regulations, is set at naught by the fact that the general definition of income has been inserted in revenue acts since the regulation was changed.

The answer to this argument is apparent:

First, the changed regulation is but a paraphrase of the decisions in the *Woods case* and similar cases.[1] The decisions in those cases are not now being questioned. Those decisions did not relate to transactions like the instant one. To the extent, therefore, that the new regulation reflects those decisions, the reenactment by Congress of sec. 22 (a) is a mere recognition of the apparent fact that sec. 22 (a) applies to transactions *of the character obtaining in those cases*. Since those cases do not purport to change the long continued construction applicable to the instant transaction, the reenactment of the last two revenue acts does not tend to overthrow Art. 66 of Reg. 74 which governs the instant transaction.

Second, if the reenactment of the section be deemed to overthrow a construction which, by long application and legislative approval, had come to have the force of law, then it follows that Congress meant to change the law (and not the regulation) and such a change in the basic law would be held only to have prospective application, in the absence of specific provision to the contrary.

Third, the regulation applicable to this case has received approval by the Board and the Courts in many decided cases, over a long period of time. The new regulation has received no such judicial approval. On the contrary two Circuit Courts of Appeals have said that it does not rule the instant transaction. (The *Squibb case, supra*, and the instant *Reynolds Tobacco Co. case*.) A third court (in the *First Chrold case*) made no reference to the long continued regulations.

[1] The petitioner does not deny this. See p. 49 of Petitioner's Brief.

Fourth, the petitioner's statement (Bf. mid. 43) that in no case "in which this Court applied the rule of reenactment did the Court do so to prevent the application of a subsequently amended Regulation," is completely negatived by the decisions of this Court in *Hartley* v. *Com'r*, 295 U. S. 216; *McFeely* v. *Com'r*, 296 U. S. 102; *Koshland* v. *Helvering*, 298 U. S. 441; *Helvering* v. *Winmill*, — U. S. — (Cf. *Ibid* 93 F. (2d) 494); and by the Eighth Circuit in *Walker* v. *United States*, 83 F. (2d) 103.[1]

Petitioner (Bf. bot. 46, mid. 47) returns to the subject of the Commissioner's powers and argues that no amount of Congressional reenactment, and no amount of Congressional sanction of a given construction, can serve to limit the power of the Commissioner to extend, contract, alter or modify legislative intendment. His argument is that to question the right of the Commissioner to change his mind (after his former regulations and decisions have been for years upheld by the Department, the Board, and the Courts) is to challenge the propriety of the exercise by the Commissioner of the discretion vested in him; and that, as in the case of *judicial* modification of a statute, only an act of Congress can override the Commissioner's altered interpretation of the law.

Such a position on his part, if sustained, would effectually remove from the courts all tax controversies between the taxpayer and the Government, and delegate the interpretation as well as the administration of the taxing statutes to administrative bureaus. The argument contained in petitioner's brief would seem to justify the belief that such a delegation would not be unwelcome to him.

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[1] A *fifth* answer may be found in *Helvering* v. *Tex-Penn Oil Co.*, 83 F. (2d) 518, affirmed 300 U. S. 481. In that case the Court observed that by the shifting of his position after his determination of a deficiency, the Commissioner lost whatever presumptions might be attributed to his position as the officer charged with making determinations. In the instant case the Commissioner made no determination that the instant transaction was taxable. Three years after the case was at issue, and after the point at issue in the Board had been agreed for settlement by the parties, and after the statute of limitations had expired (save for the proceeding in the Board), the Commissioner made his present contention and changed the regulation.

However, until such complete delegation is recognized the "construction of the meaning of congressional acts" is a function and duty which is purely judicial and is beyond the power of the executive. *Walker* v. *United States, supra*, p. 63.

The Instant Case Does Not Involve an Exemption from Tax.

In the last sentence of his brief petitioner suggests that the instant case presents an exemption from taxation. At the outset of the instant brief (and in Respondent's Brief in Opposition) it has been pointed out that this case presents no question of exemption. The Regulations, Rulings and Decisions for years have held that "if a corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and *the proceeds of such sale* will be treated as capital and *will not constitute income* of the corporation." Regs. 45, 62, 65, 69, 74, 77; L. O. 296, L. O. 426, L. O. 1035, L. O. 1035 (Rev.); A. R. R. 693, A. R. R. 799; I. T. 1802; and Board and court cases; all *supra*.

CONCLUSION.

The Court below rendered its decision in light of the legislative, administrative and judicial construction of the Act, which construction received the approval of Congress in repeated reenactments of carefully considered revenue acts. The Court gave due consideration to all the pertinent factors, and followed the clear mandate of this Court in rendering its decision. The judgment of the Court below was correct and just. It should be affirmed.

Respectfully submitted,

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December, 1938.

APPENDIX A.

Statute and Other Authorities Involved.

Revenue Act of 1928, C. 852, 45 Stat. 791:

Sec. 22. Gross Income.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

This provision was enacted in substantially the same language in the Revenue Act of 1913 and was thereafter so reenacted in the Revenue Acts of 1916, 1917, 1918, 1921, 1924, 1926 and 1928. The Revenue Act of 1928 is the controlling act in the instant case. Thereafter it was likewise so reenacted in the Revenue Acts of 1932 and 1934.

Treasury Regulations 74, relating to the Revenue Act of 1928:

Art. 66. *Sale by corporation of its capital stock.*—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation.

A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

The foregoing article is contained in practically identical language in Reg. 45 (1918 Act), Reg. 62 (1921 Act), Reg. 65 (1924 Act), Reg. 69 (1926 Act), Reg. 74 (1928 Act), and Reg. 77 (1932 Act).

Treasury Decision 4430, approved May 2, 1934, XIII-1 Cumulative Bulletin 36:

ARTICLE 66: Sale by corporation of its capital stock.

XIII-20-6792
T. D. 4430

(Also Section 23 (i), Article 176.)

INCOME TAX.

Acquisition or disposition by a corporation of its own capital stock.

Articles 543 and 563, Regulations 65 and 69, and articles 66 and 176, Regulations 74 and 77, amended.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER
OF INTERNAL REVENUE,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Articles 543 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, and articles 66 of Regulations 74, approved February 15, 1929, and Regulations 77, approved February 10, 1933, are hereby amended to read as follows:

Acquisition or disposition by a corporation of its own capital stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable

gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes.

Article 563 of Regulations 65, approved October 6, 1924, and Regulations 69, approved August 28, 1926, are hereby amended by striking out the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentences of those articles, and by adding the following sentence to those articles:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 543."

Article 176 of Regulations 74, approved February 15, 1929, is hereby amended by omitting the first and second sentences thereof, by substituting the words "a corporation" in place of the second word in the third sentence of this article, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

Article 176 of Regulations 77, approved February 10, 1933, is hereby amended by omitting the first and second sentences thereof, and by adding the following sentence to this article:

"As to the acquisition or disposition by a corporation of its own capital stock, see article 66."

GUY T. HELVERING,
Commissioner of Internal Revenue.

Approved May 2, 1934.

H. MORGENTHAU, JR.,
Secretary of the Treasury.

APPENDIX B.

Opinion of the Second Circuit Court of Appeals in *E. R. Squibb & Sons* v. *Helvering*, 97 F. (2d) 69 (see pp. 42–43, *supra*).

L. HAND, Circuit Judge.

This appeal is from an order, assessing a deficiency on the taxpayer's income tax return for the year 1932. The taxpayer is a large manufacturer of drugs and other chemicals, which in the year 1929 devised a plan to allow its customers to share in its profits. They were to take stock in a corporation organized by the taxpayer under the name of Squibb Plan, Inc., whose assets were to consist of shares of stock of the taxpayer, bought by it and sold to Squibb Plan, Inc., at $50 a share—a price below its market value at the time, but higher than in 1932. The taxpayer, as required by its contract, continued to buy its shares as they fell, and in 1932, sold a number of them to Squibb Plan, Inc. Because of the fall it realized a substantial profit, which the Commissioner included in its income for that year and on which he calculated a deficiency. The taxpayer appealed to the Board and then to this court from the Board's affirmance.

The definition of gross income—§22 of the Revenue Act of 1932, 26 U.S.C.A. §22—is in too general terms to throw any light upon the question at bar; but from 1918 to 1932 the regulations of the Treasury provided that the proceeds of the original sale of capital shares—whether more or less than par value—were capital; that purchases by the corporation of its own shares would be considered capital transactions; and that no resulting gain should be income: "the corporation realizes no gain or loss from purchase or sale of its own stock." This remained through five recensions of the tax laws—1921, 1924, 1926, 1928 and 1932—but on May 2, 1934, it was changed to the form shown in the margin.[1] The taxpayer insists that the amend-

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[1] "Acquisition or disposition by a corporation of its own capital stock.—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

"But where a corporation deals in its own shares as it might in the shares of

ment does not by its words cover the transaction in question; and that if it did, it would be unlawful, because the earlier regulation had received an authoritative interpretation through the long acquiescence of Congress, just noted. Brewster *v.* Gage, 280 U. S. 327, 336, 337, 50 S. Ct. 115, 117, 74 L. Ed. 457; Poe *v.* Seaborn, 282 U. S. 101, 51 S. Ct. 58, 75 L. Ed. 239; McCaughn *v.* Hershey Chocolate Co., 283 U. S. 488, 51 S. Ct. 510, 75 L. Ed. 1183; Koshland *v.* Helvering, 298 U. S. 441, 56 S. Ct. 767, 80 L. Ed. 1268, 105 A. L. R. 756; McFeely *v.* Commissioner, 296 U. S. 102, 56 S. Ct. 54, 80 L. Ed. 83, 101 A. L. R. 304; United States *v.* Farrar, 281 U. S. 624, 50 S. Ct. 425, 74 L. Ed. 1078, 68 A. L. R. 892.

We share the taxpayer's doubts whether it dealt "in its own shares as it might in the shares of another corporation," within the very equivocal language of the regulation. It is at least arguable that this means to cover only speculations of a corporation, and not a profit-sharing enterprise like that at bar. But in any event it seems to us that the uniform interpretation, so long placed upon §22 (a) 26 U. S. C. A. §22 (a), by the regulation and confirmed by the inaction of Congress, was imbedded in the statute so deep that only legislation could dislodge it. We need not say that no other interpretation could have been made: it is not uncommon, when a corporation buys its own shares, to regard them as still existing in a kind of limbo, so that when it sells them again, it does not reissue them de novo, but sells its own property. That convention may be sufficient constitutional basis for a statute which should tax as income the difference between the amount paid to buy in "treasury shares" and that received on their sale; we do not mean to suggest the opposite, for in such matters convention may be conclusive. Nevertheless it is very difficult—indeed to us it seems impossible—to understand how the notion of a gain to the corporation from such transactions is legally tenable, except when the sale of the shares is at a price higher than their real value at the time of the sale. Such a belief must depend

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another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes."

upon the mistaken supposition that after purchase the shares have an existence as such, and are more than a mere power to issue shares, like authorized, but unissued, shares. This seems to us unsound. Borg *v.* International Silver Company, 2 Cir., 11 F. 2d 147.

If one regards the corporation as the group of its shareholders collectively, that is very apparent. If they sell "treasury shares," bought at a lower price, what really happens is that the group has been enlarged; new shareholders have been added. Always assuming that the shares are sold at their true value, the old group has not profited because the sale of the "treasury shares" leaves the value of their own shares absolutely untouched. The purchase price received for each "treasury share" sold will by hypothesis exactly match the value of each old share, and the sold share will neither trench upon, nor leave any margin of profit for, the old shares. All that has happened is that a larger group is doing business with a proportionally increased capital. The same is true also, if the corporation be regarded as a juristic person, stricti juris. Before the sale of "treasury shares" the corporation is liable to its shareholders in the sum of their claims against it, which equal the net value of its then assets, including any increase in their value during the period when the "treasury shares" have been held. The corporate assets are of course increased by the sale, but the new shares create new liabilities which will precisely equal the increase, and there can be no profit to the corporation. The only escape from this is to treat the corporation as so completely independent of its shareholders, that its obligations to them should be disregarded in figuring its gains or losses. But to do that would completely distort the corporate income, and charge it as profit with all that it receives when it sells "treasury shares," and to credit it as loss with all that it pays to purchase them. Indeed, the whole reasoning which supports the emergence of profit from such transactions presupposes that the corporation has relieved itself of an obligation when it buys a share and creates one when it sells one. Since on anaylsis this appears to be legally untenable, it is plain that the original interpretation of the Treasury was at least permissible. We agree rather with J. R. Reynolds *v.* Com'r, 4 Cir., 97 F. 2d 302, than with First Chrold Corp. *v.* Com'r, 3 Cir. 97 F. 2d 22.

We must not be misled by those cases in which the corporation is held to have realized a gain in property sold to its shareholders for its own shares. Dorsey Co. *v.* Com'r, 5 Cir.,

76 F. 2d 339; Allyne-Zerk Co. *v.* Com'r, 6 Cir. 83 F. 2d 525. The question there is whether the cost of the property is less than what the corporation receives for it. The purchase price is measured by the extent by which the remaining shareholders profit by the retirement of the shares of the buyers; and is the full value of their shares at the time of the transaction. So too, when, as in Com'r *v.* S. A. Woods Machine Co., 1 Cir., 57 F. 2d 635, the corporation takes over and retires outstanding shares in settlement of a claim whose cash payment would have been wholly income. In both situations the remaining shareholders are enriched by the full present value of the shares; and this is part income, or all income, according as the consideration given in exchange had or had not any "basis."

In the foregoing we have excluded the possibility that at the time of sale to Squibb Plan, Inc. the shares had a value of less than $50. In fact they may have had, and if so, the question would necessarily arise whether there was a profit in this difference, and whether the former regulation forbad its taxation, or only covered differences between the prices at which shares might be bought in and later sold. My brothers believe that we should now decide both questions; they think that such a difference is taxable income and that the regulation did not forbid its taxation. I am not prepared to dissent, but the point has not been argued, and, had I been alone, I should have referred it back to the Board along with the determination of the value of the shares at the time of their sale. The order will be reversed, and the cause remanded to the Board, to assess any deficiency based upon differences between the sale price, $50, and the value of the shares at the time of sale.

Order reversed; cause remanded.

APPENDIX C.

Report of the Committee on Accounting Procedure to the Executive Committee of the American Institute of Accountants, reprinted from The Journal of Accountancy, Official Organ of the American Institute of Accountants, Vol. 65, No. 5, pp. 417–418, May, 1938:

This committee has had under consideration the question regarding treatment of purchase and sale by a corporation of its own stock which was raised during 1937 by the New York Stock Exchange with the Institute's special committee on cooperation with stock exchanges.

As a result of discussions which then took place, the special committee on cooperation with stock exchanges made a report which was approved by the committee on accounting procedure and the executive committee, and a copy of which was furnished to the committee on stock list of the New York Stock Exchange. The question raised was stated in the following form:

> "Should the difference between the purchase and resale prices of a corporation's own common stock be reflected in earned surplus (either directly or through inclusion in the income account) or should such difference be reflected in capital surplus?"

The opinion of the special committee on cooperation with stock exchanges reads in part as follows:

> "Apparently there is general agreement that the difference between the purchase price and the stated value of a corporation's common stock purchased and retired should be reflected in capital surplus. Your committee believes that while the net asset value of the shares of common stock outstanding in the hands of the public may be increased or decreased by such purchase and retirement, such transactions relate to the capital of the corporation and do not give rise to corporate profits or losses. Your committee can see no essential difference between (a) the purchase and retirement of a corporation's own common stock and the subsequent issue of common shares, and (b) the purchase and resale of its own common stock."

This committee is in agreement with the views thus expressed;

it is aware that such transactions have been held to give rise to taxable income, but it does not feel that such decisions constitute any bar to the application of correct accounting procedure as above outlined.

The special committee on cooperation with stock exchanges continued and concluded its report with the following statement:

> "Accordingly, although your committee recognizes that there may be cases where the transactions involved are so inconsequential as to be immaterial, it does not believe that, as a broad general principle, such transactions should be reflected in earned surplus (either directly or through inclusion in the income account)."

This committee agrees with the special committee on cooperation with stock exchanges, but thinks it desirable to point out that the qualification should not be applied to any transaction which, although in itself inconsiderable in amount, is a part of a series of transactions which in the aggregate are of substantial importance.

This committee recommends that the views expressed be circulated for the information of members of the Institute.

Respectfully submitted,

COMMITTEE ON ACCOUNTING PROCEDURE,
George O. May, *Chairman*,
Samuel J. Broad,
Arthur H. Carter,
A. S. Fedde,
Henry A. Horne,
Frederick H. Hurdman,
Roy B. Kester,
Rodney F. Starkey.

SUPREME COURT OF THE UNITED STATES.

No. 328.—October Term, 1938.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* R. J. Reynolds Tobacco Company.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[January 30, 1939.]

Mr. Justice Roberts delivered the opinion of the Court.

The sole question for decision is whether gain accruing to a corporation consequent on the purchase and resale of its own shares constitutes gross income within the meaning of Section 22 (a) of the Revenue Act of 1928.[1]

The respondent, a New Jersey corporation, on occasions between 1921 and 1929, purchased its own Class B common stock for reasons of policy, such as the elimination of a very large single holding, the broadening of the ownership of the stock, and the support of the market to protect the investments of employe shareholders. This stock was resold from time to time. While held it was treated as treasury stock and the cost of it was entered in the accounts as "Investments in Non-competitive Companies". The books showed no increase or reduction of capital stock on account of purchases or sales. During 1929 the company sold shares acquired in that and prior years for a sum which exceeded cost by $286,581.21, which amount was entered in the books as a cash item and added to surplus. In its income tax return for 1929 the company listed this gain under the caption "Other Items of Non-Taxable Income", as "Profit R. J. R. Stock".

The Commissioner determined a deficiency in the tax paid for 1929 involving items not here in controversy and the company appealed to the Board of Tax Appeals where those items were adjusted. Before the case was closed the Commissioner by amended answer alleged that the taxpayer's net income should be increased by

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[1] c. 852, 45 Stat. 791.

the amount of the "net profit realized . . . through trafficking in Class B common stock of the . . . Company", and claimed a resulting deficiency. He based his claim upon Treasury Regulation 74, Article 66, as amended by a Treasury decision of May 2, 1934,[2] which states "where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another."

The Board, after finding the facts in detail, sustained the Commissioner.[3] The Circuit Court of Appeals reversed the Board's ruling.[4] Because of asserted conflict we granted the writ of certiorari.[5]

Section 22 (a) is: "General definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever." Section 62 directs the Commissioner, "with the approval of the Secretary" of the Treasury, to "prescribe and publish all needful rules and regulations for the enforcement of this title." Article 66 of Treasury Regulations 74, promulgated under the Act of 1928, so far as material, is: "If . . . the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock."

Petitioner contends that, as Congress must be taken to have exercised its constitutional power to the fullest extent in laying the tax, Section 22 (a) should be held to include the gain realized from sales of a corporation's own stock, and the quoted regulation can-

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2 Treasury decision 4430, XIII-1 Cumulative Bulletin 36.

3 35 B. T. A. 949.

4 R. J. Reynolds Tobacco Co. v. Commissioner of Internal Revenue, 97 F. (2d) 302.

5 See First Chrold Corp. v. Commissioner, *infra*, p. —.

not restrict the scope of the statutory definition. The respondent replies that such gain is capital gain and not income, as is demonstrated by the theory and practice of accounting[6] and by court decisions.[7] The court below found it unnecessary to decide this issue, holding that whether the increment is income is at least a debatable question and the regulation was, therefore, proper as an interpretation of the meaning of the section. We agree that Section 22 (a) is so general in its terms as to render an interpretative regulation appropriate.[8]

The administrative construction embodied in the regulation has, since at least 1920, been uniform with respect to each of the revenue acts from that of 1913 to that of 1932, as evidenced by Treasury rulings and regulations, and decisions of the Board of Tax Appeals.[9] In the meantime successive revenue acts have reenacted, without alteration, the definition of gross income as it stood in the Acts of 1913, 1916, and 1918.[10] Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law.

The petitioner concedes that if nothing further appeared he would be bound to apply the statute in conformity to the regulation. He asserts, however, that the amendment adopted by the Treasury May 2, 1934, while this cause was pending before the

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[6] See e. g. Dickinson, "Accounting Practice and Procedure", 130, 132; Sunley and Pinkerton, "Corporation Accounting", 121; Streightoff, "Advanced Accounting", 134-5.

[7] Johnson v. Commissioner, 56 F. (2d) 58; E. R. Squibb & Sons v. Helvering, 98 F. (2d) 69; compare Borg v. International Silver Co., 11 F. (2d) 143, 147; Commissioner v. Inland Finance Co., 63 F. (2d) 494; Carter Hotel Co. v. Commissioner, 67 F. (2d) 642.

[8] Morrissey v. Commissioner, 296 U. S. 344, 354.

[9] See L. O. 1035, 2 C. B. 132, 3 C. B. 140; L. O. 998, 5 C. B. 211; L. O. 426, 1 C. B. 210; A. A. R. 693, 5 C. B. 207; I. T. 1198 C. B. I-1, 275; A. A. R. 76 C. B. I-1, 374; I. T. 1892, C. B. II-2, 267; Reg. 45, Arts. 542 and 563; Reg. 62, Arts. 543 and 563; Reg. 65, Arts. 543 and 563; Reg. 69, Arts. 543 and 563; Reg. 74, Arts. 66 and 176; Reg. 77, Arts. 66 and 176; Simmons & Hammond Mfg. Co., 1 B. T. A. 803; Cooperative Furniture Co., 2 B. T. A. 165; Atlantic Carton Corp., 2 B. T. A. 349; Hutchins Lumber & Storage Co., 4 B. T. A. 768; Farmers Deposit Nat. Bank, 5 B. T. A. 520; H. S. Crocker Co., 5 B. T. A. 537, 541; Interurban Const. Co., 5 B. T. A. 529; Liberty Agency Co., 5 B. T. A. 778; Union Trust Co., 12 B. T. A. 688, 690; 105 West 55th Street, Inc., 17 B. T. A. 210, 213; American Cigar Co., 21 B. T. A. 464, 495; Carter Hotel Co., 25 B. T. A. 933.

[10] See R. A. 1913, § II. B, 38 Stat. 167; R. A. 1916, § 2 (a), 39 Stat. 757; R. A. 1918, § 213 (a), 40 Stat. 1065; R. A. 1921, § 213 (a), 42 Stat. 238; R. A. 1924, § 213 (a), 43 Stat. 267; R. A. 1926, § 213 (a), 44 Stat. 23; R. A. 1928, § 22 (a), 45 Stat. 797; R. A. 1932, § 22 (a), 47 Stat. 178.

Board, is controlling. By the amendment Article 66 is made to read: "Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. . . .

"But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. . . . Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes."

Petitioner urges that the amendment operates retroactively and governs the ascertainment of gross income for taxable periods prior to the date of its promulgation, and, further, since Congress has reenacted Section 22(a) in the Revenue Acts of 1936 and 1938, it has approved the regulation as amended. We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.

Section 605 of the Revenue Act of 1928 provides that "In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect."[11] It is clear from this provision that Congress intended to give to the Treasury power to correct misinterpretations, inaccuracies, or omissions in the regulations and thereby to affect cases in which the taxpayer's liability had not been finally determined, unless, in the judgment of the Treasury, some good reason required that such alterations operate only prospectively. The question is whether the granted power may be exercised in an instance where, by repeated reenactment of the statute, Congress has given its sanction to the existing regulation.

Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend

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[11] 45 Stat. 874. Somewhat similar provisions were contained in earlier acts. See Revenue Act of 1921, Section 1314, 42 Stat. 314; Revenue Act of 1926, Section 1108(a), 44 Stat. 114.

to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed. We need not now determine whether, as has been suggested,[12] the alteration of the existing rule, even for the future, requires a legislative declaration or may be shown by reenactment of the statutory provision unaltered after a change in the applicable regulation. As the petitioner points out, Congress has, in the Revenue Acts of 1936 and 1938, retained Section 22 (a) of the 1928 Act *in haec verba*. From this it is argued that Congress has approved the amended regulation. It may be that by the passage of the Revenue Act of 1936 the Treasury was authorized thereafter to apply the regulation in its amended form. But we have no occasion to decide this question since we are of opinion that the reenactment of the section, without more, does not amount to sanction of retroactive enforcement of the amendment, in the teeth of the former regulation which received Congressional approval, by the passage of successive Revenue Acts including that of 1928.

The judgment is affirmed.

A true copy

Test:

Clerk, Supreme Court, U. S.

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[12] Squibb & Sons v. Helvering, 98 F. (2d) 69, 70.